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The Meaning of Value

Fundamental Economic Concepts





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The Meaning Of Value*

By PETER HANSON, M. A. I.

VALUE is purchasing power. The nature of value is to command other commodities in exchange. Value, as generally used, is expressed in terms of money and as of a given date.

The term "market value" as applied to real estate is unsatisfactory and confusing. Its use has become more or less obsolete in three respects.

1. It does not conform to fact and actual practice.
2. It does not conform to the economic concept of value.
3. It does not fully conform to legal interpretation.

The use and meaning of the term has been handed down to us by our courts. It has come out of many decisions—with each decision centering around a specific case, but seeking, in its interpretation, to be of general application to all cases.

Real estate sales do not reflect value—they merely indicate selling price—a meeting of two minds as to a particular transaction.

In real estate practice there is no such thing as "market value" in the strict meaning of the term. The commodity of land is not handled—bought and sold—in that way.

The only sound standard by which to measure the value of real property is by its use value—its ability to produce benefits.

Warranted Value is what market value ought to be.

Warranted Value is that sum, estimated in terms of money at a given date, which a person would be justifi-

fied in paying for the future net benefits accruing from a property.

No "Market Value" For Land

Let us now examine and analyze the meaning of the foregoing statements. The term "market value" can only mean one thing—value in the market—selling price. Such use of the term may be true of other commodities, but it is not true as applied to land. This is because the commodity of land is not handled in this way—bought and sold in the market as are other commodities. The common useful articles of life, such as food and clothing, may be purchased at the corner grocery or at the clothing store, at a generally recognized price, which is the known value in the market at the time—the market value. And in the same way we may buy stocks and bonds on the stock exchange at a fixed and known price as of the date of purchase. This price is its recognized market value.

Not so with land. There is no "stock exchange" for land. It has no known price—no market value in this sense of the use of the term. Neither is there a "corner grocery" where one may go and buy a piece of land at a tabbed price. The purchase or sale of land is not handled in this way. Land is too individualistic to be handled in any such manner.

The result is that the term "market value" as it has come to be used and applied to land is not market value, but is nothing more or less than selling price. We all know that the value of land rests on something far deeper and more fundamental than the mere accident of a real estate sale.

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—Author.

Not Economic Concept

Market value is not in line with our economic concept of value—the use value of property, that is, its capacity to earn or produce benefits. In some court decisions, however, there is some slight recognition of the use value of property, but usually in such a way as to stress the fact of the sale, and the price paid, rather than the use value of the property as such.

Survey of Definitions

The legal definitions of market value are unsatisfactory, and often contradicting and confusing. In the effort to arrive at a definition our courts have used such expressions as “willing buyer and seller”, “cost and price”, “full knowledge”, etc., etc. While such conditions are logical academic enunciations, they do not obtain in actual practice. At best, but a very small percentage of actual sales conform, either in whole or in part, to the legal requirements of “full knowledge”, etc., and, therefore, cannot possibly serve as criteria of market value.

Realizing the confusion existing in the use of the term “market value”, the writer undertook an analytical study of supreme court decisions in the several states in the effort to interpret their meaning and probable intent. This study covered a period of nearly five years, and included several hundred condemnation cases dealing with the term market value.

Because of lack of space, only a few cases are cited here. But these will suffice to show the method of approach and the manner of analysis. In each case the meat of the decision was broken up into its legal elements, and these, in turn, segregated as to classification. The decisions given here are typical of the leading cases in the several states, and so may safely be used as a guide in our study.

Sixteen Legal Elements

It is interesting to note, that out of this entire study, after breaking up the decisions into their legal elements, and then summing up the classified results, we found a total of only sixteen separate legal elements.

Definitions of Market Value

A California Case —

“*Market Value* is the highest price estimated in terms of money which the land will bring if exposed for sale in the open market, with a reasonable time allowed to find a purchaser, buying with full knowledge of all the uses and purposes to which it is adapted, and for which it is capable of being used.”

Sacramento Southern R. R. Co. v. Heilbron, 156 Cal. 408.

Elements

- | | |
|------------------------|-------------------|
| 1. Highest price | 6. Full knowledge |
| 2. In terms of money | 7. Uses—all |
| 3. If exposed for sale | 8. Purposes |
| 4. In open market | 9. Adaptability |
| 5. Reasonable time | 10. Capability |

A New York Case —

“In estimating reasonable *Market Value* of property condemned, the owner is entitled to have considered the adaptability of the land to the purposes for which it could most profitably be used, but it is to be considered only so far as the public would have considered it, if the land had been offered for sale.”

Inwood Hill Park v. City of New York, 189 N. Y. 642; 197 App. Div. 431.

Elements

1. Adaptability
2. Purposes
3. Most profitable use
4. As considered by public
5. If offered for sale.

A New Hampshire Case —

“*Market Value* of property is the price which the property will bring in

a fair market after fair and reasonable efforts have been made to find a purchaser who will give the highest price for it."

Lake C. case of W. Mfg. Co. v. Town of Guilford, 67 N. H. 514; 35 A. T. L. 945.

Elements

1. Fair market
2. Reasonable effort
3. Highest price
4. Buyer will give
5. Property will bring

A West Virginia Case —

"The true test of the *Market Value* of land taken for a public use is the price for which it could have been sold, by a person desirous of selling, to a person willing to buy, neither acting under compulsion, and both exercising intelligent judgment."

Baltimore & Ohio R. R. Co. v. Bonafeld's Heirs, 79 W. Va. 287.

Elements

1. Price
2. Could have been sold
3. Desire to sell
4. Willingness to buy
5. No compulsion
6. Intelligent judgment.

An Illinois Case —

"The land owner was entitled to the highest cash *Market Value* of the part taken, considered as a part of the whole, for the best use to which it was adapted, and not as a separate and distinct piece of real estate disconnected from the rest of the tract."

City of Chicago v. Farwell, 296 Ill. 415; 121 N. E. 795.

Elements

1. Highest cash market value
2. As part of whole
3. Not as separate parcel
4. Disconnected from rest.

A Virginia Case —

"In estimating *Market Value* of property, all capabilities of the prop-

erty and all uses to which it may be applied are to be considered."

Seaboard Airline Ry. Co. v. Chamblin, 108 Va. 42; 60 S. E. 727.

Elements

1. All capabilities
2. All uses.

A Mississippi Case —

"The inquiry in such cases must be, what is the property worth in the market, viewed not merely with reference to the uses to which it is applied, but with reference to the uses to which it is plainly adapted."

Mississippi & B. R. R. Co. v. Patterson, 98 U. S. 403.

Elements

1. Not only present uses
2. All uses to which plainly adapted.

A California Case —

"The basis for computing the *Market Value* of land where its suitability for subdivision purposes is established, is its value, plus any increased value it may have in the market by reason of its suitability for subdivision into city lots, and not on the basis of what the owners would be able to obtain for the lots after subdivision had actually taken place. . . Subdivision possibility, but not as an actuality."

City of Los Angeles v. Hughes, 202 Cal. 731.

Elements

1. Reasonable highest and best use.

A California Case —

"The chance that land will increase in value as population increases, and new facilities for transportation and new markets are created, is an element of value quite generally taken into consideration in the purchase of land in estimating its *market value*. This chance of gain is the property of the land owner, . . . The expected en-

hancement of value through the general improvement of the country is a legitimate motive for investing in property."

Beveridge v. Lewis 137 Cal. 619.

Elements

1. Expected increase in value.

A United States Case—

"The value of the property results from the use to which it is put, and varies with the profitableness of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use. The amount and profitable character of such use determines its value."

C. C. C. & St. L. v. Backus, U. S. Court, May 26, 1894. (Opinion of Chief Justice Brewer, U. S. Supreme Court.)

Elements

1. Use value only
2. Not cost.

It will be observed that in this decision the United States Supreme Court does not use the term "market value".

Segregating the Elements

By summarizing the several decisions and their component legal elements we have a fairly complete analysis of the generally accepted *Legal Elements* which enter into and define *Market Value* as used and interpreted in condemnation actions. These elements are as follows:

1. Price (not value) estimated in terms of money.
2. Under average market and normal economic conditions.
3. After fair efforts to sell and with proper advertising.
4. And with reasonable time allowed to find a buyer.
5. In free and open market, but not under forced conditions.

6. With willing to sell, and willing to buy conditions as between buyer and seller.
7. Buying with full knowledge as to all the facts concerning the property.
8. And exercising intelligent judgment.
9. Not necessarily a sale, nor its value in use for speculative or subdivision purposes.
10. Not necessarily its value in its present use.
11. Not its value to the owner for any immediate or future plans which he may have for the use of the property.
12. Not its value in use to the owner, nor to the buyer.
13. Not its value in a particular use, but its value in any use.
14. Not its value for special uses or purposes, but its value for all uses and purposes to which the property is naturally adapted, and for which it is capable of being used.
15. Its value as measured by the highest and best and most profitable use to which the property may be put.
16. Its value arising out of use based upon its ability to produce benefits.

It will be observed that these elements logically divide themselves into four groups of four each. The first group has to do with sale conditions, or the manner and conditions under which a sale should be made. The next four have to do with the conduct of the buyer and his knowledge of the property. The third group deals with the present or prospective use conditions of the property, while the last group is concerned solely with its value. Let us examine these four groups further to find their relationship and the part each plays in the definition of the term *Market Value*.

In the first group we find certain hypothetical sale conditions—qualifying conditions which must attend a sale in order to make it conform to all the legal requirements of the defini-

tion of *Market Value*. Such a sale must be made under *fair market* conditions, after *fair efforts* have been made to sell the property, and with a *reasonable time* allowed in which to effect a sale. It will be noted that none of these conditions has to do with the *Value Elements* as such. They are merely sale conditions. The value of a property does not depend upon the manner of the sale.

The second group has to do with the relationship of the buyer and the seller in the transaction, rather than with the property itself. It involves the items of freedom of action, intelligent judgment, and the amount of knowledge the buyer has as to the property. Here again, in this group, we are dealing with conditions more or less external to the property, and not with the value fundamentals inherent within the property. Any condition attending a sale must be regarded as a secondary element, and not as a fundamental consideration.

Condition of Use

The third group deals with the use conditions of the property. Land utilization varies and the position which the courts have consistently held is that the market value of property is not necessarily its value in its present use, nor in any use which the owner may plan for it in the future. Neither is its market value set by its value in use to the owner, nor to the party seeking to condemn. Any condition of use is not in itself a safe criterion by which to measure market value. It is also pointed out that there need not be an actual sale of the property, and that its value for speculative purposes cannot be considered. The main difference here is that this group deals with the use conditions of the property, whereas, the first two had to do only with the sale conditions.

The fallacy of fixing market value

by its present use condition is best shown when we realize that often conditions of use are mere temporary expedients, such as "tax-payers", and do not represent the highest earning capacity of the property.

The fallacy of determining market value by any future plans, or speculative uses which the owner may have for the property is seen in the fact that such plans may not materialize, and are often too future and uncertain for the appraiser to compute and measure market value by.

The fallacy of setting up its market value from its value in use to the party seeking to condemn lies in the fact that it is beyond the scope of *eminent domain* proceedings to inquire its value in its new use. It is sufficient that it is for a public use.

Use Value

The last group of legal elements deals solely with the use value of property. Here we have it clearly pointed out that market value is not its value in a particular use or for a particular purpose, but its value in any use to which it is naturally adapted and for which it is capable of being used. But this is purely a use value concept and not a market value definition in the strict sense of the term. The confusion lies in a failure to distinguish clearly between value and price. These terms are not one and the same, but their similarity of use has often lead to contradictory meanings.

This concept of value is all-important because it has to do only with those economic qualities inherent in and environing a property, and not with any outside or exterior considerations which are usually secondary in effect. Because it is basically and fundamentally sound from the economic standpoint, it necessarily constitutes the only true standard by which to measure value.

For our guidance in the matter our courts have gone even further and have pointed out that the market value of property taken in *eminent domain* proceedings should be interpreted to mean its value in its highest and best use. Present conditions of use or intended use are immaterial. The position taken here is that the property owner is entitled to the value of the property taken, measured by the most profitable use to which it is capable of being put. This position is both fair in principle and equitable in its results.

In all this we must conclude that *Use Value* is fundamental. Every known test of real property valuation over a long-time period must ultimately come to rest upon its use value, not its selling price.

Legal Intent

We are now in a position to inquire into the legal intent. What was it the courts sought to convey in setting up and pointing out the several elements of *Market Value*? What was their purpose? At best, it must be construed as an effort clearly to define the meaning of the term. In our analysis there are four main elemental considerations.

1. Sale conditions—the manner of making the sale.
2. Buying conditions—knowledge and conduct of the buyer.
3. Use conditions—present or planned uses of the property.
4. Value conditions—its value in its highest and best use.

The first consideration must be construed wholly as an effort to lay down the conditions under which a sale must be made in order to conform to the legal requirements of the definition.

The second consideration has to do with the conduct of the buyer in the transaction—his willingness and freedom of action, his knowledge of the

property and the matter of using good judgment in the purchase.

The third consideration involves the use condition of the property. What the property may be used for at any time is unimportant. The question is not its value in any use at any time, either to owner or to buyer, but its value for all uses to any person who may own it.

The fourth consideration is fundamental in its meaning and application. It involves all the value fundamentals—setting, location, adaptability, and economic capabilities.

The first three items must be construed as more or less limiting and qualifying in their force and effect upon the definition, and not as fundamental in respect to the value of the property.

What Do We Mean

From the foregoing it would almost appear that our courts have given too much attention to the definition of *Market Value* as such, and too little attention to the value concepts, with the result that the term has become somewhat hackneyed and confused in meaning. The reasons for this are obvious. In the past our courts have largely relied upon sales to establish market value. This practice has undoubtedly come into use upon the theory that cost and value, and price and value are the same thing.

Perhaps it would be better if we could get away from the term entirely. But this may be impossible because of the long time it has been in vogue and read into the law and the statutes. However, since market value tends in the long run to adjust itself to use value, it would seem that the term might easily be clarified in legal language so as to conform more nearly to our accepted economic value concepts. We are not so much concerned with what

a property sells for as we are concerned with its ability to produce benefits. Certain it is that value rests upon something far deeper than the mere chance or accident of a real estate sale.

This is not a far step. Perhaps it might be brought about by a slight modification of the term *Market Value*. In our effort to define it, we may have over-stressed the meaning of the word *Market*, as if the *Market* part of the term were more important than the *Value* part. At first glance it would appear that a simple phrase like—*"based upon its ability to produce benefits"*—might clarify our appraisal thought, and give us an acceptable definition that would meet all the legal requirements and at the same time satisfy our value concepts. The term would then read—*"market value based upon its ability to produce benefits."*

Objections to the Legal Term

Establishing market value by law will never be wholly satisfactory, and there are many objections to the strictly legal use of the term. Clearly, too much emphasis has been placed upon the sale idea. Sales may be properly used as supporting data in an appraisal, but not as evidence of value in themselves. There are too many unknown influences and circumstances surrounding the average sale to make it a safe criterion by which to measure value. Some of the chief objections to its strict legal usage may be noted as follows:

From the Standpoint of the Appraiser

1. Value rests upon something far deeper and more fundamental than the mere chance or accident of a real estate sale.
2. The circumstances surrounding any sale, lack of understanding, salesmanship pressure, etc., are never fully known, and yet they may be the chief factors in setting the price.

3. Price is a matter of agreement between two people. Two persons may agree upon a certain price for a property, while two others may agree upon an entirely different price for the same property. Both are selling price.

From the Standpoint of the Court

1. Our courts stand in the position of expounders of the law, and not as appraisers and economists.
2. It is inevitable that some of our courts should not fully comprehend the fundamental economic principles involved.
3. Each case is a specific case, but the principles laid down are of general application to all cases.

From the Standpoint of Changing the Present Legal Set-Up

1. Long and continued confusion of value with cost and price.
2. Long practice of our courts in relying largely upon sales to establish market value in court actions.
3. Hesitancy and reluctance to change common usage and accepted practice, long written into the law and statutes.

Market Value Confusing

As we sum up, then, the legal thought surrounding the term *Market Value* as shown in the several decisions quoted here, and as we sum up the objections to the strict legal use of the term, we are confronted with a situation that is not only incompatible with the facts but is also out of line with our highest economic concepts.

We find ourselves in this position because the wording of the definition has grown up around the now obsolete idea that value rests upon selling price, and also because the phrasing of the language has been chiefly concerned with the manner and conditions of a sale, with the result that the value fundamentals have been almost neglected. The effort to combine these three has only further confused the issue.

Market value as generally used and defined in our leading court decisions is not market *value*, but market *price*. Prices may or may not represent value. The fact that market value tends in the long run to align itself with use value does not justify the assumption that market value is use value.

Even a modification of the term as above suggested—*based upon its ability to produce benefits*—cannot be satisfactory because that is only another way of saying that market value is not market value, and does not help us to get away from the word *market*. Its only advantage is that it would give us *what market value ought to be*, instead of what *market value is*, as now used.

Perhaps our only solution lies in getting away from the term "*market value*" entirely, and substituting the term "Warranted Value" or "Use Value". For after all, in the strict sense of the term as now used, land may be said to have no market value.

Warranted Value

To change from the term "*market value*" to "*warranted value*" would undoubtedly meet with some objections from the legal standpoint, both because of the long and generally accepted use of the term, and also because of the fact that it is written into the law and the statutes. In addition to this, there is a long line of court decisions which might be affected, involving the risk of being reversed, and so bring into question the legality of the proceeding.

However, we are facing a situation which calls for a strong position, not only by the appraiser and the economist, but also by our judicial and legislative bodies. Perhaps if we will all recognize this fact we may be able to come to some agreement and understanding which will give us a satisfac-

tory definition and clarify the legal status.

In the term "warranted value", we have the combined concepts of justified value, use value, investment value, and benefits. Warranted value, then, is what a person *would be justified* in paying for a property based upon its ability to produce benefits. Since past benefits have expired, we are concerned only with the future benefits of the property.

This change would get us entirely away from the term "market value". This is as it should be, for after all, we are not appraising market value—we are appraising *what market value ought to be*. Warranted value is what market value ought to be.

Warranted value is that sum, estimated in terms of money at a given date, which a person would be justified in paying for the future net benefits accruing from a property.

A Necessary Step

In a little treatise on "Condemnation Appraisal Procedure" written two years ago, I advanced the necessity for a new meaning of market value in the following words:

"Because we (economists and appraisers) have failed to give sound expression to a definition of **market value**, we have been put in the position of being required to conform our definition to legal interpretation, whereas, we should be in the position where legal interpretation should conform to a generally accepted and established definition and meaning of market value. It is not the Court's job to define market value. That is our job. The doctor does not make out his prescription by law. In my opinion the market value of real property should be interpreted as its **use value**. This is the same standard of measurement set up by Chief Justice Brewer in 1894. It is the only sound standard by which the value of real property can be measured under the economic concepts. For after all, we are not appraising market value—we are appraising **what market value ought to be**."

My continued study of court decisions since then has but served to confirm my convictions on this point. We have reached a place in our appraisal thinking where the definition of value must rest on its own feet. We understand the economics of land better. Court decisions on market value are often contradictory and misleading. We have floundered trying to harmonize the economic facts with the legal interpretation. All this has only led to confusion and subterfuge. Sound appraisal practice demands a change. Court procedure demands clarity and understanding. The logic and necessity of the situation demands a change.

The chief advantages of this step may be noted as follows:

1. It is a step in the right direction.
2. It tends to clarify our appraisal thought.
3. It is in line with advanced appraisal practice.
4. It gets away from continued subterfuge and confusion.
5. It is in full accord with the "before and after" theory.
6. It harmonizes our legal thought with our appraisal thought.
7. It is in line with our best definitions and court decisions.
8. It would undoubtedly be welcomed by the bar and the judiciary.

Value Definitions

"Warranted Value is that sum, estimated in terms of money at a given date, which a person would be justified in paying for the future net benefits accruing from a property."—Peter Hanson, M. A. I.

"The value of the property results from the use to which it is put, and varies with the profitableness of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use. The amount and profitable character of such use determines its value."—United States Supreme Court Case.

"The inquiry in such cases must be, what is the property worth in the market, viewed not merely with reference to the uses to which it is applied, but with reference to the uses to which it is plainly adapted."—Mississippi Case.

"The market value of a property at a designated date is that competitively established price which at that date represents the present worth of all the rights to future benefits arising from ownership."—Standards of Appraisal Practice.

"Market value is that reasonable and fair value, which under normal or ordinary conditions, an owner would be justified in expecting for a sale of the property, if all the facts concerning the property were known, and the property were properly advertised."—Ivan A. Thorson.

"Market value is the highest price estimated in terms of money, which the land will bring if exposed for sale in the open market, with a reasonable time allowed to find purchaser, buying with full knowledge of all the uses and purposes to which it is adapted, and for which it is capable of being used."—California Case.



Real Estate Appraisal Practices

A report* prepared on behalf of the Committee on Realty
Finance of the National Conference on Construction.

By ARTHUR J. MERTZKE, Ph. D.

DURING the past decade the construction industry climbed to an unprecedented volume (in 1928), and then tobogganed to the smallest volume in recent years in 1931, with the decline continuing into 1932.** Accompanying this acrobatic behavior of the construction curve, we find an equally unprecedented volume of defaults, foreclosures, receiverships, demoralization in real estate securities, bankruptcies, unemployment, rent declines and building vacancies.

To what extent these distressing experiences might have been avoided, and if so, by what means, are outstanding questions engaging the attention of the construction industry.

Three Basic Problems of This Report

Attention is directed at the outset to three major problems involved in this report. These are:

1. To point out the extent to which the welfare of the construction industry is dependent upon appraisals (Section II of this report).
2. To set forth the distinctions between real and false appraisals (Sections III, IV and V of this report).
3. To suggest means by which those who bear the responsibility of financing the construction industry may bring about a more dependable type of appraisal service (Section VI of this report).

II. IMPORTANCE OF APPRAISALS TO THE CONSTRUCTION INDUSTRY

While engineering genius has developed a technique which enables it to erect physically safe structures

towering to more than one hundred stories, the economic soundness of many construction projects has been scrutinized with far less concern by those who were financially responsible for them. The result has been an unparalleled number of financial crashes resulting in staggering losses to many thousands of investors. While these tragedies can not all be attributed to unsound appraisals, there is a growing volume of evidence that the owners of many of these ill-fated projects relied for their security upon a species of guesswork masquerading under the name of appraising, which is no more entitled to that designation than a counterfeit bill is to be considered lawful currency.

Economic Soundness

The term "economic soundness" as here employed has reference to the capacity of a property or building project fully to pay for itself with interest during its economic life. Unlike physical soundness, economic soundness does not depend wholly upon factors within the physical limits of the property, but depends to a large extent upon outside, surrounding influences and future developments. Economic soundness depends upon the type of improvement, the location, the demand for the type of property in question, the character of the management under which the property is operated, the volume of existing or

*Publication approved by the Acting Director of the Bureau of Standards of the United States Department of Commerce.

**According to the F. W. Dodge Corporation, contracts awarded in 37 states increased to \$6,628,300,000 in 1928 and then dropped to \$3,092,900,000 in 1931.

potential competition to which it is exposed, and other similar factors.

An admirably designed and well-constructed office building, for example, would be an ill-advised project for a site adapted primarily to hotel or apartment development, and this fact should be clearly shown by competent appraisers. Similarly, a new apartment-hotel, consisting of small residential units, would be economically unsound in a neighborhood in which vacancies in similar properties are already numerous or in which prospective developments of similar projects may result in excessive competition, with consequent falling rentals, an increasing percentage of vacancies, or both.

These examples illustrate the relationship of a thorough appraisal service to the construction industry and demonstrate the fallacy in the assumption frequently made, sometimes by so-called appraisers, that all the factors governing the value of a property are confined within its four walls. Consequently we are warranted in advancing the opinion that a vast number of ill-advised building projects would never have gone beyond the blue-print stage had these projects been subjected to thorough analyses by competent appraisers, because such analyses would inevitably have disclosed their unsoundness as bases for the loans which were made to finance them. A sound appraisal should be the very keystone in the plan of every construction project, since the financial success or failure of the project will depend upon its economic soundness.

Role of Appraiser in the Construction Industry

The highly responsible role of the appraiser in the construction industry can be clearly set forth by defining the

primary duties or functions of an appraiser, which are:

1. To analyze properly all factors affecting the value of the property to be appraised;
2. To estimate the probable economic or profitable life of the property;
3. To compute correctly the value of the property as of a given date; and
4. To present in his report sufficient evidence supporting his conclusions to enable those financially interested in the property to act with safety.

III. THREE BASIC TESTS OF VALUE

In order that those who have occasion to employ the services of an appraiser may be able more readily to distinguish between genuine and counterfeit appraisals, it may be helpful to summarize briefly the basic tests of value employed in all types of valuation work.

There are only three basic tests of economic value which an appraiser can employ in appraising a given property. He may base his valuation upon (a) the cost of production of the property, including both land and improvements; (b) the prevailing market prices of similar properties; and (c) the expected earning capacity of the property. Many appraisers have in the past chosen one or another of these three tests as the primary one. As a result we have what may be termed three distinct schools of appraisal thought based upon these three fundamental tests of value. A fourth school might be mentioned which recognizes none of these three tests as final and conclusive, but employs all three in estimating the value of a given property.

Cost of Construction

The first basic test of value is founded upon the theory that the value of any property is determined

by its cost of construction or reconstruction, minus an allowance for depreciation or obsolescence. Adherents to this method consider that no one is better qualified to appraise a property than a builder or contractor, since he is most able to accurately compute the cost of the physical components of the property, and they support their position on an old economic generalization that the value of reproducible goods in the long run tends to be equal to their cost of production.

While this may at first thought seem to be the most plausible method of determining property values, a slight amount of reflection will disclose grave weaknesses in this line of reasoning. Among these we may mention first the fact that it neglects the highly important factor of the suitability of a given improvement to its location. According to this theory a residence, apart from its ground value, would have the same value on a downtown business site as it would in a suburban location or in the country, and a commercial hotel located in a desert would have the same value as if it were in the heart of a metropolitan center. This rule also ignores fluctuations in market prices and entirely omits consideration of the property's earning capacity as if this were of no consequence. Furthermore, according to this principle, a building which is only ten per cent occupied would be appraised at the same value as a similar structure more favorably situated which is ninety per cent occupied. Similarly, this principle does not take into account the fact that many structures are so situated that they may be subjected to veritable blizzards of competition which may develop as a result of overbuilding, ruining property owners and investors alike, even though the properties involved would, if appraised according to their cost of construction alone,

represent sound values and secure investments.

In fairness to the cost method of estimating property values it should be said, however, that this test furnishes a means of fixing a fairly accurate maximum limit on building values, because a building cannot ordinarily be worth more than would be the cost of replacing it with a similar structure. In the event, therefore, that another method points to a higher figure than that represented by cost of replacement minus a reasonable allowance for depreciation and/or obsolescence, the cost method furnishes conclusive evidence that there is some flaw in any other method that leads to a higher apparent value.

Market Prices

The second school of thought, representing what we may term the market value group, attempts to base its appraisals primarily upon the prevailing market prices of similar properties.

The most serious fault of this method is the difficulty of finding sales of strictly comparable properties upon which to base a fair estimate of the value of a given property. Due to the comparatively large number of sales of houses and lots of all types, there is less difficulty in applying this rule to residential properties or to vacant parcels of land than to large store or office buildings, but even in the case of residences or vacant land it is impossible to find exactly comparable properties, so that at best this method serves only as a rough guide in estimating individual property values. Another fault of this method arises from the difficulty of securing correct selling prices, as they are frequently disguised or erroneously reported; but even granting that the real prices paid are known, it does not follow that these either prove or rep-

resent real values. Personal situations on both the buyers' and the sellers' sides frequently result in sales above and below true values, and in times of booms and depressions real estate prices in entire communities depart from sound values by very wide margins. Consequently, selling prices can at best be employed only as aids in determining real values, but cannot be relied upon as a conclusive test of the sound value of any given property.

Again it may be said, however, that if market prices of certain types of properties are collected in sufficient numbers and over sufficiently long periods to reflect market trends, these data may be employed as a standard by which to approximate values by comparing a given property with the selling prices of a representative number of similar properties. Hence this method affords an effective means of checking the values of properties such as houses and lots, in communities where a sufficient number of sales of comparable properties have taken place to afford satisfactory samples.

Earning Capacity

The third basic test of value depends upon the expected net earning capacity of the property. Consequently this method is restricted to properties which yield a cash return or involve benefits to their owners that can be measured in terms of money, which may then be converted into a capital sum representing the value of the property by a process known as "Capitalization". This is merely the technical name for a method of determining the amount of money which a purchaser would be warranted in paying for a property from which he desires to realize a certain rate of return upon his investment.

Like the cost method and the market price method discussed above, the earning capacity method also has its

handicaps. First of all there is the task of determining the income and operating factors with sufficient accuracy to compute an accurate current net yield. The next and still more difficult factor to be determined is the probable future trend of cost and income factors and the consequent uncertainty in accurately estimating what the prospective net earnings will be and how long the useful or profitable life of the property may continue. While, from the point of view of the investor, this is a factor of paramount importance, it is impossible to foresee all of the still non-existing factors which may arise and which may completely change the economic picture visible at the time the appraisal is made. Consequently, it must in all fairness be said that while this method of appraising income properties is theoretically unsailable, it is encumbered with important difficulties which arise from the hazards incident to an accurate prediction of future earnings.

Importance of Earning Capacity

In the final analysis, however, the value of any income property depends solely upon the return which it will yield, and hence no appraiser is warranted in making an appraisal which represents the value of any income or investment property as being in excess of the present worth of the net earnings which it may reasonably be expected to yield during its remaining economic life. The principal limitation of this method lies in the fact that it is not readily applicable to houses, factories, and other properties that do not have clearly ascertainable net earnings measurable in terms of money.

The outstanding and primary reason for making an appraisal of an investment property for loan purposes is to determine its capacity to yield a return sufficient to justify the investment in the property, since no investment in a property is warranted which will not

be fully repaid with interest. Appraisals for investment properties should indicate clearly the volume of earnings above taxes and operating charges that will be available to discharge principal and interest payments. To lenders, therefore, net earnings represent a factor of even greater importance than the appraised valuation of the property, which they do not desire to purchase, to sell or to own.

Equally important from the lender's point of view is the probable duration of net earnings. A property such as a small store and office building, or a small apartment building, may yield a net return of \$5,000 per annum at the time it is appraised. If, however, an investor were to make a long-term loan upon these properties on the assumption that this volume of net earnings would continue during the term of the mortgage, he would be practically certain to find his loan in distress if, at the end of three or five years, net earnings had fallen to one-half of their original volume. Since *the volume and duration of the net earning capacity* of the property is the primary concern of lenders on all types of income properties, these two factors are of greater importance to investors than the final appraised value of the property.

Applicability of Earnings Method to Construction Projects

It is frequently argued that in the case of construction projects which are still to be built, the income method of appraising is impracticable because there are no earnings upon which to base such an analysis. The same argument, however, would preclude the possibility of designing or even considering such projects since the promoters are, as a rule, interested in them solely from the point of view of the return which their investment will yield. Consequently, it is clearly with-

in the province of an appraiser to offer a solution of this problem on the basis of projected plans and specifications.

The argument is frequently advanced that appraisals for conservative first mortgage loans may be different from appraisals made for such purposes as condemnation, junior financing, and sale or settlement of an estate. From the point of view of a thorough and competent appraisal this line of reasoning is no more logical than it would be for a physician to make a different diagnosis of a case of appendicitis, depending upon the occupation of the patient. As far as the appraisal is concerned, the purpose for which it is desired should make no difference except that in reporting the result of his analysis an appraiser may place more emphasis on particular factors if he is familiar with the specific purpose for which the appraisal is made.

All Methods Correct Under Ideal Circumstances

The foregoing criticisms of the three basic tests of value are not intended to discredit the possibility of making a sound appraisal, but rather to show that there is no simple formula applicable to all cases, and that the best appraisers can make a trustworthy valuation only after careful study and analysis of all factors pertaining to the particular property under consideration, including probable changes in market prices, rentals, building costs, changes in uses of properties, growth and movements of population, and other basic factors.

The fact may here be noted that under ideal conditions all three of these methods would theoretically produce the same result. In other words, an income property correctly designed, properly located and perfectly constructed should, under normal economic conditions, yield a return fully

commensurate with the investment in the property, and its market value should be equal to its full normal cost of construction. The appraiser has no right to assume, however, that anything about the property is ideal, and consequently he is as much responsible for pointing out and weighing factors which detract from the value of the property as he is for crediting the property with those factors which contribute to its value.

IV. SUMMARY OF CURRENT APPRAISAL PROCEDURE

There is a bewildering variety in the actual appraisal procedures followed by appraisers today. However, a partially completed study of the practices adopted by insurance companies, investment bankers, savings banks, commercial banks, trust companies, building and loan associations, appraisal

companies, and real estate boards has led to four general classifications as to the degree of completeness in the method of procedure and the resulting reports. These classifications are:

1. The unsupported statement of the appraiser or an appraisal group as to its opinion of the value of the property.
2. Limited data collected or verified by appraisers used as the basis for the same type of report as in class 1.
3. Considerable written data obtained by the appraiser and some method by which the appraiser's work is reviewed.
4. A detailed report analyzing the property from every angle in accordance with the better scientific principles.

No Written Data Employed

In the first type of procedure, which unfortunately is still widely practiced,

Exhibit 1. A Typical Unsupported Certificate of Appraisal

CERTIFICATE OF APPRAISAL

Date.....

To:

We, the undersigned, being duly appointed for the purpose, by the (institution) issuing this certificate, hereby certify that we have carefully considered the application for an appraisal of the property described herein; that we have personally examined said premises; that we have no personal interest in the property, and in our opinion said property is worth:

Land	\$.....
Improvements	\$.....
Total	\$.....

Committee:

.....

(Seal)

Exhibit 2. A Typical Form of Certificate of Appraisal Based Upon Limited Data.

VALUATION COMMITTEE'S REPORT
 of (Name of Loaning Institution)

City.....19.....

Property of
 Location: No.....Streetside
 Between
lotin Square..... No.....
 Front,.....Feet; rear,.....feet; depth,.....feet; contains
square feet;.....footway in front; has.....alley
feet wide on the.....of lot. Street is.....graded.
pavement sewerage
 Improvements:

 Assessed in the name of —

Assessment value:

Lot..... Sq.....,Sq. Ft. at..... \$.....

 Improvements:
 Total \$.....

We estimate the present value of the improvements
 in this location..... \$.....
 \$.....
 Lot.....per foot.....
 Total \$.....

Valuation Committee:

.....

(Seal)

we find a document purporting to be a certificate of appraisal or in some cases a less formal paper or letter which is subscribed to by from one to three individuals as appraisers. There is no evidence of any written material gathered in support of the valuation figure. The "appraisal" merely sets forth the opinion of the signators as to the value of the property.

A certificate typical of this class is shown in Exhibit 1.

Among the conditions sometimes appended to such an appraisal are phrases to the effect that the description, income and such special data upon the property as are submitted by the applicant are assumed by the committee to be correct; that no responsibility is assumed by the committee; and that title is assumed to be good.

Limited Data Employed

The second general classification embodies a procedure of a slightly higher degree of development, requiring a somewhat systematic gathering of certain basic facts in writing to serve as a foundation for the valuation of the property.

The form shown in Exhibit 2, which is executed by the valuation committee, is typical of this method.

In some instances each member of the committee may be supplied with a copy of the applicant's detailed description and be required to make his inspection alone, checking carefully the applicant's statements. The members meet later and determine what the valuation shall be. While the effectiveness of this method as generally used by certain loaning institutions is based upon serious personal attention of the appraisers employed, it is classified in the second group because of the limited amount of data gathered in making an appraisal and the informal character of the appraisal report.

Data Fairly Complete and Carefully Checked

In the third classification we find appraisals which show a marked degree of improvement over those encountered in groups one and two. The appraising personnel in this category is generally more experienced or equipped with a better background than the average appraiser. Also there is usually more or less of a system in operation involving the use of standard work-sheets by the inspectors and requiring a statement in writing indicating the reasons for the valuation. At a certain stage prior to the final approval of the valuation, a competent group of individuals may review the work of the appraisers to determine the reasonableness of the valuation. In arriving at a figure both the appraisers and the reviewers usually have access to files of appraisal data which may be applied in addition to that gathered.

An example of appraisal procedure falling within this class is furnished by the practice of an institution making real estate loans throughout the country. This company establishes local correspondents to appraise property and recommend loans in that community. The company also employs regional supervisors (twelve in number) who visit the correspondents in their respective regions and in addition actually inspect the various properties. Two or three general supervisors are retained to check the regional supervisors. The local correspondents are bound further by contracts to the effect that they will assume the loan if the security (appraised property) is unsatisfactory to the central organization. Before the final approval of an application, the appraisal department of the main office makes a careful technical examination.

Procedures of this third group are

probably the most effective of the generally practiced methods.

Complete Data With Elaborate Reports

Classification four, representing the highest degree of scientifically developed appraising, is used comparatively little, though it is gradually becoming more widely recognized.

It consists first of a careful study of the entire problem by exceptionally well qualified experts who, after compiling the necessary field data on carefully prepared work-sheets, turn to their "work shops" where they compute the valuation and prepare the report. At the "work shop" one finds an up-to-date file of appraisal references and data and experienced co-workers with whom various points may be discussed.

One sample appraisal of this type consisted of a first page as a certificate of appraisal with the remaining seventeen pages dealing with the data and explanations in support of the valuation. Among the items discussed are: the location of the property, to which a page of discussion was devoted; data covering transportation facilities (1 page); legal description of the land; description of the improvements with a tabular analysis of the kinds of rooms and floor space; the valuation process (3 pages); tabulation as to income; operating cost and expense; and other important elements essential to proper appraising.

This latter practice undoubtedly results in a figure nearest to an accurate valuation of the property partly because of the methods employed and partly because the original object is to find the real value, whereas the other methods are utilized principally by institutions whose primary concern is in the fact that the appraisal figure shall *not exceed* the real value of the property. The point should be stressed,

however, that appraisals made on the basis of "playing safe" from the lender's point of view are unfair to the owner, just as excessive appraisals reverse these interests. Fairness to all parties concerned demands that appraisals be accurate and made without bias in favor of either lenders or borrowers, buyers or sellers.

V. WEAKNESSES IN CURRENT APPRAISAL METHODS

While the appraisal profession has made very commendable progress during the past decade, there are still many appraisers who regard the emphasis which is being placed upon adequate data and correct principles as if they were nothing more than showy window dressing.

While those who fail to consider definitely formulated principles and technique may frequently be right in their conclusions, one of their principal weaknesses lies in the fact that under changing conditions there is danger of their falling into error due to a lack of technique for weighing and measuring changing factors. But perhaps the greatest fault in such procedure lies in the ease with which it may be imitated by wholly incompetent and untrustworthy appraisers, since the only requirement upon them is their signature to a sheet of paper stating that, in their opinion, a certain sum represents the value of the property.

Reliance Upon "Common Sense"

The foregoing remarks should not be construed as relegating to the scrap-heap, the vitally important factor of common sense in appraising. On the contrary it is assumed that true common sense must be the very essence of good appraising, and that it will serve in the field of appraising just as it does in engineering or other fields. No amount of theoretical procedure can

make an appraisal satisfactory without good judgment and the application of sound common sense. Sound judgment, proper data and correct principles are all equally necessary in making a true appraisal and the proper application of all three is the only adequate insurance against counterfeit appraising done by those who are deficient in any or all of these essentials, but who conceal their faults under the pretense of "common sense".

Faulty Theories of Value

Another group of appraisers which has led many investors in financial institutions astray includes those who embrace faulty theories of value. While the subject of value constitutes one of the most technical concepts in economics and has been ably expounded in numerous court decisions and voluminous treatises, there are still many who call themselves appraisers who have invented their own amateur theories, apparently unaware of the fact that the subject has been given extensive thought by many able minds over a long period of years.

Again we find another group which adheres tenaciously to simply one of the three basic tests of value described earlier in this report, ignoring the limitations and shortcomings inherent in each of these tests, which have already been indicated.

Inadequate Data

Another weakness of many appraisals lies in the fact that known or ascertainable data have been improperly or inadequately used. Many an appraiser points with pride to the photographs attached to his appraisals, the market price data carefully entered upon a plat book of the city and figures on costs of various types of construction, but can furnish no information relative to such vital matters as rentals, operating costs or net yields of invest-

ment properties in the community. While elaborate and complicated appraisal forms may not be necessary, there are certain essential data without which a proper appraisal analysis is impossible, and which should form the basis of every properly substantiated appraisal.

Incommensurable Factors

There are other limitations in current appraisal methods which are due largely to the influence of immeasurable factors which comprise the twilight zone of speculative considerations. Such factors as the influence of skyscraper construction, the effects of rapid transit development, automobile transportation, and industrial decentralization have an unquestionable influence upon property values; but their measurement presents difficulties which the appraisal profession so far has not solved with a gratifying degree of success.

Summation Appraisals

Frequently separate appraisals are made of the land (or leasehold) and the improvements, which then are added to obtain the value of the entire property. The worst results of this method grow out of a practice sometimes employed of having such parts of properties appraised by different appraisers, and adding the figures obtained from each to represent the total value of the property.

This practice is condemned as unsound, inaccurate and misleading because it disregards the effect of over, under, or misplaced improvement. In the case of investment properties it evades the fundamental question of the economic soundness of the improvement and disregards the interrelation between land (or leasehold) value and the value of the improvement.

Other Weaknesses

The most inexcusable weaknesses in current appraisal practices are: (a) failure on the part of appraisers to keep abreast of the appraisal technique employed by the more competent appraisers throughout the country, and (b) allowing anyone to represent himself as an appraiser who consciously or fraudulently misrepresents property values for the purpose of collecting a fee for his services.

VI. RECOMMENDATIONS FOR IMPROVING CURRENT APPRAISAL METHODS AND PROCEDURE

More Adequate Data

Doubtless the greatest handicap experienced by all appraisers at the present time is the lack of adequate real estate data. Information reflecting the current demand and supply of various classes of properties, rentals, market prices, operating costs, and construction costs are exceedingly meager, and as a rule appraisers desiring to employ such information are compelled to assemble it themselves. It is strongly urged that suitable agencies for compiling information of this type be encouraged not merely for the purpose of supplying such information currently, but also to serve the equally important purpose of providing a basis for determining the trends of each of the above-mentioned factors.

Research on Basic Trends

Another field of inquiry deserving of considerable research is the study of trends in land uses and the consequent effects as reflected in trends of site values.

While considerable work has been done by the Bureau of Internal Revenue, The National Association of Real Estate Boards and others in estimating the economic life of real estate improvements, this subject is also recommended for further research.

Better Qualifications for Appraisers

Another vital improvement in appraisal methods may be hoped for through the establishment of better qualifications for appraisers by some agency such as the American Institute of Real Estate Appraisers, which has recently been organized by the National Association of Real Estate Boards. In addition to refining the standards of appraisal practice, such an organization could also periodically disseminate information with reference to the entire field of appraising and could exercise a wholesome supervisory power over its membership through the medium of properly drawn membership requirements. Such an organization could, moreover, go far toward fixing a degree of responsibility upon appraisers for making erroneous and faulty appraisals.

It is further suggested that the establishment of fuller information in public records regarding real estate, additional research by educational institutions and foundations with reference to the more basic problems concerning the great dynamic movements which are taking place in the real estate field, and more detailed studies involving the practical application of the fundamental principles of real estate values, would be of great value to appraisal practice.

Qualifications of a Competent Appraiser

Worthy efforts are being made to raise the standards of the appraisal field to those of a true profession, through courses in real estate appraising which are now offered in many colleges, universities, and other organizations, through research activities and publications in the appraisal field, and through the formation of a professional society of appraisers, such as the American Institute of Real Estate Appraisers previously mentioned.

The cooperation of those requiring the services of an appraiser is urged to aid in bringing about a more competent type of appraisal service by choosing appraisers who are properly qualified to render a trustworthy service. Among the qualifications which every appraiser should possess are:

1. Honesty.
2. Sound judgment.
3. Knowledge of the principles and technique of appraising acquired through study and experience.
4. Knowledge of the uses of the types of properties to be appraised.
5. Knowledge of rentals paid for the types of properties to be appraised.
6. Knowledge of the operating costs involved in the types of properties to be appraised.
7. Knowledge of the cost of construction, replacement, or remodeling of the types of properties to be appraised.
8. Knowledge of financing terms and prices paid for properties similar to those to be appraised.
9. Ability to take a long-time view of considerations which must be weighed and analyzed in appraisal work, particularly those which affect the future net income yielding power of the property.
10. Willingness to learn and the habit of keeping abreast of the best standards and practices in the appraisal field.



Percentage of Cities Reporting Upward, Stationary or Downward Movements of Residential Rents as Compared with Same Date, 1932

Section and Size of City	Single-Family Dwellings			Two-Family Dwellings			Apartments		
	Up	Stat.	Down	Up	Stat.	Down	Up	Stat.	Down
Totals for U. S. and Canada.....	6	42	52	1	28	71	1	25	74
New England	7	50	43	....	47	53	....	43	57
Middle Atlantic	2	42	56	2	22	76	....	17	83
South Atlantic	4	50	46	3	23	74	4	18	78
East North Central	30	70	....	19	81	....	22	78	....
West North Central	6	33	61	....	22	78	....	22	78
East South Central	67	33	....	33	67	....	33	67	....
West South Central	31	38	31	....	47	53	....	47	53
Mountain	45	55	....	17	83	....	17	83	....
Pacific	14	49	37	2	43	55	2	33	64
Canada .....	....	100	....	....	100	....	....	100	....
Over 500,000 .....	....	100	....	11	89	....	....	100	....
200,000 to 500,000.....	6	53	41	5	35	60	....	25	75
100,000 to 200,000.....	4	41	55	....	29	71	....	28	72
25,000 to 100,000.....	7	38	55	1	27	72	1	23	76
Under 25,000	9	57	34	2	33	65	2	32	66
District and County Boards.....	4	32	64	....	23	77	....	22	78

—from Semi-Annual Survey, National Association of Real Estate Boards, July 23, 1933.

Fundamental Economic Concepts

By LORING O. MCCORMICK and GEORGE L. SCHMUTZ

MOST evaluators, and particularly real estate appraisers, are prone to consider Land and Capital as the sole factors in the production of Income or of Benefits. Most appraisal processes and formulae are designed so as to measure the contribution of these factors alone. The tendency to do so and thus to neglect Labor and Organization as contributory factors in production has led to much confused thinking and writing, and is responsible in a great measure for the apparently irreconcilable differences of opinion between the proponents of "Valuation by Reproduction" and "Valuation by Capitalization" methods. Because of the failure of valuers also to consider Labor and Organization as factors in production, the importance of all factors in production will be herein stressed, and their relationships carefully inquired into, in order that a clear understanding of the fundamental factors underlying the production of wealth and of services be grasped by the student, as a foundation for the understanding of valuation procedure.

Nature and Man as Factors

In the most fundamental sense, Nature and Man are the primary, and in-

dispensable, factors in the production of all things. Nature furnishes all of the materials and forces out of which wealth is created. By his intelligence, Man directs the processes of production; and by his physical Labor he directs the forces of Nature used in production, and supplements them.

Capital as a Factor

A third factor in production arises as an effect of the coupling of Man and Nature in Production; and this third factor is known as Capital. For the purpose of this work, Capital will be considered only as the difference between what Man and Nature have produced, and that which Man has not consumed, and which is used for the purpose of further production. Under this definition, — machinery, tools, buildings, furniture, automobiles, etc. are to be considered as Capital, while goods and commodities destined for consumption are to be considered as Consumptive goods.

Organization as a Factor

Organization may be defined as the sum total of these factors used to co-ordinate the offices of Labor, Capital, and Land in the production of goods or of services. Management, public

This is the first of a series of articles, by Loring O. McCormick and George L. Schmutz of Los Angeles, on the *Economic Approach to Valuation Procedure*. The second article will appear in the October, 1933, issue and will deal with the *Doctrine of Surplus Productivity*, the *Doctrine of Contribution*, the *Creditor's and Debtor's Positions*, *Long Term Tendency of Land*, and *Rent*. The theories and procedures set forth in these articles will be interesting and valuable to the student and the practitioner; but they are not to be interpreted, however, as having the official approval of the American Institute of Real Estate Appraisers.—Editor.

utility services such as light, heat, water, power, and taxes, special assessments, insurance, etc., are all factors of Organization and are necessary effectively to coordinate Labor, Capital, and Land in their function of production.

Relationship of the Factors

The four factors in Production, namely Nature or Land, Man or Labor, Capital, and Organization have been briefly defined. However, such brief definition does not convey a clear understanding of the nature of these factors, nor of their relationships one to the other, nor the causes affecting them. Inasmuch as a clear understanding and a thorough knowledge of all of these factors is necessary to secure an understanding of the principles governing valuation processes, it will be necessary to treat of these four factors in a more exhaustive and detailed manner.

The Part of Nature and Man in Production

Nature furnishes the surface of the earth as a foundation for the diverse activities of Mankind, and as well furnishes all of the raw materials and forces which Mankind uses in the production of goods, services, and wealth. During the past two hundred years the advancing knowledge of Mankind has discovered the use of Power, and of the hidden forces of Nature. The discovery and application of these forces of Nature has revolutionized industry, has elevated the Standard of Living, has affected the utilization of all forms of Land, and has increased the value of Land as well. These changes occur as Man advances in knowledge; and it can reasonably be expected that our future advance will be more rapid than in the past. In advancement, the only thing which is really limited at any particular moment in time is the knowledge of Man, and a survey of

the World's History indicates that the greatest sources of wealth are not the materials and forces which are furnished by Nature, but rather the Creative Knowledge of Mankind which discovers the forces of Nature and develops them, and the means for their utilization. Russia, China, India, and many South American countries are rich in raw materials but are poor in wealth for the reason that the people in general have but little knowledge of Nature's bounties, or as how best to develop and utilize them. For this reason it may be truthfully said that,—the wealth of a nation lies as much in the intelligence of its people as in its possession of raw materials and natural resources.

Land Includes Natural Resources

When we consider Land, we must consider it, not only as soil or as a superficial area of the Earth's surface, but also as inclusive of all Natural Resources. These Natural Resources are divisible into two general groups,—Renewable and Non-Renewable, a partial list of which follows,—

Renewable	Non-Renewable
water	coal, gas, oil,
soils	iron and other metals,
forests	and minerals.

It is not necessary herein to enter upon a lengthy discussion of the conservation of these Natural Resources but it is necessary for the student to consider Land as meaning both the superficial area of the Earth and all natural resources of whatever description. The need for so considering Land will become more apparent as we proceed with the discussion of these fundamental factors upon which valuation processes are dependent.

Labor Changes from Raw to Finished Product

We have seen that progress and the creation of wealth is primarily based

upon the use of Natural Resources by the Labor of Mankind. In considering the resources of Nature, we must bear in mind that they are not always supplied by Nature in a condition that would fully satisfy human wants and desires. Ores of the various metals were placed in the earth by Nature, but the ore—as it comes from the mine—is not yet fit to satisfy the needs of man. It must be treated by various processes and oftentimes combined with other substances before it emerges in a form capable of satisfying our wants. Before it gravitates to urban use, raw land must also have its raw state changed; grading, pavement, sidewalks, sewers, etc., are necessary to render the Land as a finished product capable of meeting human urban requirements. Nature has furnished the raw materials and forces of industry and Man's knowledge has sought them out, found uses for them and has invented ways and means of fashioning them into products which satisfy wants, and therefore products of value. The finding of these raw materials and forces and of uses of them, and the finding of means whereby they are made into want satisfying products, constitutes the part of Labor, or Man's part in Production.

Divisions of Labor

Labor is generally divided into four divisions as follows:

1. The Labor of Science,
2. The Labor of Invention,
3. The Labor of Management, and
4. Direct Labor.

We have previously stated that the wealth of a nation may be more in the brains of its Men than in its possession of raw materials and resources. The truth of this statement will be clearly seen after we have considered the Labor of Pure Science.

The history of the world is largely

an account wherein Man's discovery and utilization of the forces and properties of Nature are chronicled. In history, the Stone Age was ended by the discovery of Bronze, and the Bronze Age terminated with the introduction of Iron. In the past one hundred years, the age of Steel and Electricity have displaced Iron, and this period of time, commonly known as the Industrial Age, has witnessed more progress than all previous time.

Labor of Science and Invention

The works of Edison, Steinmetz, and others, in electricity, and of Fulton, Parsons, and Seldon in locomotion; of Bell, Marconi, and others, in communication and radio, shows that the Labor of Pure Science always comes first,—that we can largely measure our wealth by the extent of our possession of profound and creative intellects.

Before scientific discoveries can be put to work, means must be invented for so doing. Science and Invention react—one to the other. A discovery of Science is flashed to the World and inventive genius finds means for utilizing the discovery, and once it becomes utilized, it leads to a further solving of problems and scientific discovery. The invention of the automobile aptly illustrates this principle; and the later stages of finished production are ever dependent upon the Scientist and the Inventor.

The development of the automobile, the street car, and the railroads have led to a rapid change in the manner of utilizing Land; and developments in the chemical and manufacturing fields have raised our Standard of Living, have increased the amount of goods produced and consumed, and thereby has increased the ability of and the need for urban Lands to render increased services, all of which has led to an increase in the value of Land.

If we contrast the aggregate value of land in a Chinese City of one million people with the aggregate value of land in an American City of like population, we are immediately impressed by the fact that Land value is not dependent upon mere population, but rather upon the intensity of the use of Lands, and we find that these aggregate Land values are roughly proportional to the per capita production and consumption of goods. That the Labor of Science and of Invention are responsible for the difference, thus becomes obvious.

The growth of super-provision markets, designed so as to provide the greatest diversification of goods, thus conserving the time of the shopper, would be impossible without the Labor of Science and Invention which first provided the means of transportation of shoppers to and from the site.

Prior to the Labor of Science which produced steel in structural forms, and computed the safe stresses to which it could be subjected, there were no centers of real value in cities for the reason that the services which Land could render were limited by the size of the buildings which could be placed upon the Land, and the sizes of buildings in turn were limited by the strength of available materials. The rapid growth of urban Land values in all of our large cities has been the result of more intensive use of Land as exemplified by larger structures, made possible by the invention of structural steel, preceded by scientific discoveries of the metallurgist. Thus is it seen that the greater the production and consumption of goods, and the more intense the use of land, the greater the amount which can be paid for the use of Land.

In the final analysis, any value of Land which is in excess of values that exist in countries where production is

primitive, is the outgrowth of the Labors of Science and Invention. These profound changes in urban Land values, caused by the Labor of Science and Invention, are still going on.

Houses, and even districts, rapidly become obsolete; subways and elevated railroads destroy, and create values; and so also does the widening of streets, and the change of traffic arteries, and the separation of grade crossings, which are occasioned by the rapid growth and use of the automobile, —a product of the Scientist and the Inventor.

Capital as an Offspring of Nature and Man

In an elementary manner, we have shown that the Primary Factors in Production are Nature and Man. As an offspring of these two, there arises that which is known as Capital. Capital is the sum total of all economic goods, with the exception of land, used, or capable of being used, to further production, or to satisfy human wants.

This definition of Capital divides wealth into two parts—first, Consumption goods (commodities possessed by consumers) and second, Capital goods (used for further production) such as,

1. permanent improvements to land such as sidewalks, pavement, sewers, etc.,
2. factory buildings, barns, office buildings, rental buildings, etc.,
3. machinery and tools, rolling stock of railroads, etc.,
4. raw and auxiliary materials of production,
5. stocks of goods for sale,
6. money.

Consumption Goods are those possessed by consumers and in their hands for the purpose of present, near present, or continuing consumption; they thereby yield their utility directly and quickly, while Production Goods yield

their utility indirectly and slowly. The difference between a Consumption and a Production Good is merely a matter of *time* and *degree* as both are means to want satisfaction, sooner or later. Groceries in the hands of the consumer, which are Consumption Goods, yield their utility quickly, that is,—they are consumed in a short space of time; contrarily, an office building yields its utility slowly, i. e., it may last for fifty years.

A residence used by the owner for the satisfaction of his own wants is a Consumption Good, while if rented to another becomes a Production Good.

Fixed and Circulating Capital

Capital is often spoken of as being either Fixed or Circulating. In industrial production, Capital generally starts the cycle as a series of money, the first step being the purchase of Land, structure, machinery, and raw materials; the second is the transformation of raw materials into finished products; the third is the exchange of the finished product for money. The money and the cycle is repeated. This rotation of Capital from money to finished product and back again is called its turnover, and the time of turnover varies with different branches of industry. It is this relationship which Capital Goods bears to the cycle of production that has led to the distinction between Fixed and Circulating Capital. In general manufacturing, if the cyclical period be one year, we would class raw materials as Circulating Capital, and the machinery and buildings as Fixed Capital. This difference must be constantly held in mind.

Coal or oil for heating an office building, cleaning supplies, light globes, etc., and money reserved for labor, taxes, insurance, etc., are Circulating Capital while the more permanent parts of the building such as the structure, furnishings, etc., are Fixed

Capital. The need for the difference between Fixed and Circulating Capital becomes clear when we consider that interest must be charged on Circulating Capital as well as on Fixed Capital, even though the Circulating Capital is not a part of the real estate. If, at the time of a valuation, the amount of necessary Circulating Capital be below that amount necessary properly to service the property, we would overvalue the property.

In this respect it is necessary for the appraiser to make an estimate of the amount of Circulating Capital necessary for the normal operation of a property or business, and to charge a justifiable rate of interest thereon, which is set up as an expense of the property. If this is not done, i. e., a proper charge is not made for the use of Circulating Capital, then the property will show an excess of earnings, which Capitalized reflects a greater value for the realty than actually exists. A stock of linen in a hotel organization may cost \$10,000 and may have yielded one-half of its utility, thus reducing its value correspondingly, and unless \$5,000 be set up for the amount of such Circulating Capital, the property might be overvalued by many thousands of dollars. The quantity of Circulating Capital varies for different properties and different types of business and should always be taken into consideration, if it is of an appreciable amount. Thus is seen one of the necessities for distinguishing between these two forms of capital.

Organization as Coordination

In the discussions of Nature, Man, and Capital, and their respective parts in production, we have stressed their importance; it is also necessary that their interdependence be fully recognized if we are to arrive at a clear understanding of appraisal procedure. Either Land or Capital may be unproductive, considered separately; simi-

larly, they might be unproductive when combined, unless Organization (e. g., management) enters the picture and furnishes means whereby they are coordinated for effective production. Viewed in this light, Organization appears as an arrangement of Land, Labor, and Capital, for the purpose of producing commodities or rendering services. Every business concern is such an arrangement, and all such arrangements involve,—first a plan of arrangement; second, specialized parts; third, a form of management control; and fourth, a common end or purpose. In an apartment house, there is first an arrangement of Land and Building, Labor and Management; second, a specialization of tasks,—the Land furnishes foundation and area,—the building furnishes shelter; third, control is centralized in owner or manager; and all four of these factors work to a common end, i. e., the production and sale of space and services.

The Costs of Organization

Where *Organization* enters to render productive the arrangements of Land, Labor, and Capital,—of necessity it must pay the costs involved in their use in order that effective co-ordination be had and be maintained. The payment of taxes, insurance, special assessments, laundry, electricity, water, gas, garbage disposal, etc., are some of the costs involved when the other productive factors are coordinated for effective production; and all costs which arise in rendering effective the production of Labor, Capital, and Land, are properly considered as Costs of Organization.

Utility and Scarcity as Factors

The value of any factor in production is determined by how much it adds to the Joint Product, over and above the costs of its use; and it follows that the appraiser should have a

clear concept of what determines such costs, and hence the supply price of the productive factors. To this end, the costs of Labor, Capital and Organization will be covered in a general, yet fundamental sense. It will be shown that the value of any factor in Production is determined by its productivity, in so far as value to the user of the productive factors is concerned. On the other hand, we find that as regards products of industry, cost enters as a secondary cause governing Scarcity. The two fundamental causes of values are Utility and Scarcity. Then, cost influences Value on the Scarcity side, and Utility on the Demand side. In the coming discussion of the Doctrine of Contribution, we will examine Utility operating on the Demand side. The same reasoning is true of our examination of the other productive factors. For this reason, we will turn to an examination of causes which operate on the Supply side—bearing in mind that the exchange value of the productive factors, (wages, profits, interest, and rent) are governed by Scarcity and Cost, as much as by Utility and Productivity.

Wages, Rent, and Interest

That share of the Joint Product given to Mankind for Labor is known as Wages, and in the final analysis, wages are paid for the personal services of Mankind; Rent is paid for the *use* of Land and Natural Resources; and Interest is paid for the use of Capital. In each case, what is really paid for is productive power, and in the case of Land, or of Capital, or of Organization, the value of the productive powers of these respective factors can be separated. It makes little difference to the owner of Capital whether it be used in an office building, in a public improvement or in an industry, if it is believed to be safe. However, to Labor, it may make a great deal of difference whether it be employed in an

office building, at an oil well, or in a sewer.

Types of Wages

Labor is highly perishable while land and capital are not. It must also be recognized that Labor and its owner cannot be separated, and that the manner of employment becomes of great moment. In considering the wages paid for Labor we must make a sharp differentiation in terms. A "nominal" wage of \$10 a day might only be an "actual" wage of \$5 per day, if the man is employed but half time. Also we must draw a sharp distinction between "money" wages and "real" wages. The amount of "money" that Labor receives is the "money" wages; the amount of commodities his money will buy is the "real" wage. The latter, i. e., the "real" wage is the factor of greater moment but unfortunately is obscured by careless speech and thinking.

Labor—Factors on the Supply Side

It is axiomatic that an increase in population will increase the Labor power of a country, and that the natural tendency of population is to increase in geometric ratio, such as 1, 2, 4, 8, etc., while the food supply tends to increase in arithmetic ratio such as 1, 2, 3, 4, etc. Population always treads upon the heels of production, and each additional increase of food wrested from the soil is gained at a more than proportionate expenditure of energy. There are two checks against the natural tendency of population increase as follows:

1. the *moral check*, which reduces the birth rate; and/or contraception; and
2. the *positive checks* of War, Famine, and Disease.

The moral check is widely used in those countries where the people are

highly educated, such as England, France, Germany, and the United States; but they are not used to any great extent in those countries where the people have remained in comparative ignorance. This check has allowed the above countries to place their population beyond the claws of famine, and to increase their production, wealth, knowledge, and Standard of Living. The positive checks to population growth, i. e., War, Famine, and Disease, operate mostly in those countries such as China, India, and others where the pressure of population against the means of subsistence leaves but little time for the advancement of knowledge, or the accumulation of capital to be used in further production.

The situation in the latter countries is generally further complicated by religious beliefs which seems to render it more glorious to be hungry, diseased and ignorant, than to be well fed, healthy and educated. Such pressure against the means of subsistence, as exemplified in these backward countries, invariably leads to revolution, warfare, and disease; and in China in a single season, millions may die of typhus or cholera when crops fail; and misery stalks the land.

In the more advanced countries in the World, where the birth rate is controlled, we find that the demand for Labor increases more rapidly than the supply, as a long time process. When the population increases but slowly, and the per capita production of goods increases rapidly, real wages and the Standard of Living increase rapidly. If the per capita production of goods should increase forty per cent in a decade, then normally about 96 per cent of such increase goes to Labor, thereby tending to increase the "real" wages of Labor, and holding down the proportion which would accrue to Land, or Natural Resources. The fact

that the limiting of population and the growth of capital production tends to hold down the proportion of the Joint Product accruing to Land for its part in production, does not mean that a rise in the value of Land is thereby precluded for, as it has been previously seen, the value of Land tends to increase as it performs greater services, that is, as its use becomes more intensive, due to the amount of commodities and services it creates, distributes, or renders.

Labor—Factors on the Demand Side

The value of Labor is influenced by both material things and mental forces. To analyze these factors in detail would be a lengthy task, and for this reason only the simplest factors of Supply and Demand will be considered. The Demand for Labor arises from the demand for the products produced by the aid of Labor. An increase in the demand for products of industry will create a demand for workmen, and this tends to raise wages. Also, it must be constantly borne in mind that increased knowledge tends to add to both the efficiency and productivity of labor, and so also does the use of power in industry. In the long run, power machinery and Labor tends to raise the real costs of wages by reducing the costs of commodities and by increasing the productiveness of Labor, and hence its price, and by increasing consumption and demand for Labor's product and thereby ultimately increasing the demand for Labor itself. Over long periods of time, as the productiveness of Labor increases, the other factors in production receive a lesser percentage of the gross income while Labor receive more and more. This is true only in those forward countries where the population increases at a rate less rapid than the increase in production.

Wages Determined by Productivity

An income producing property constructed in 1900 may have had ten per cent of the gross income imputable to Labor for the part it plays in the production of services; today, even though *value* of the gross income may not have changed (i. e., its purchasing power), the cost of labor, i. e., real wages, has more than doubled, while the returns to the other factors in production has diminished, if expressed in percentages. The past thirty years discloses the fact that Labor—real wages—increased about forty per cent per decade, and this tendency should be taken into consideration when estimating future operating costs and computing future net incomes.

In conclusion, the price of "real" wages of Labor tends to be set by its productivity, which in turn is controlled by education, through the use of power machinery in industry, and by contraception and the natural population checks which influence the ratio between productivity and population.

Capital Cost—What It Is

Interest is that part of the gross income imputable to Capital for the part it plays in production. Capital is not furnished free, like many of Nature's goods, but is brought into existence by labor and saving, and can be considered as the conserved energy of mankind. Therefore, some stimulus is necessary in order that saving insure an adequate supply of Capital, and to cause owners of Capital to abstain from its use, and to loan it to others. In the final analysis, capital has value for the same reason that other goods have value, i. e., Scarcity on the one hand and Utility on the other. The price of Capital, that is,—the rate of Interest, is determined by the Supply of and the Demand for it, similar to other forms of wealth.

Capital Costs—How Influenced

At any moment in time, the supply of loanable capital is the difference between what has been produced and consumed, and not yet employed. For example, if our yearly production was 200 billion dollars and our consumption was 190 billion, then the difference of 10 billion dollars (if not yet employed) would represent the amount of new capital created and available for loans.

Any increase in the quantity of money, or of credit, would lead to higher price levels, while a decrease would lead to lower price levels, and it is mostly by reason of the effects of rising or falling price levels on the supply side of, and demand side for capital which sets the Interest rate. A period of rising prices stimulates production and consumption, increases the demand for capital, raises the Interest rate and brings about a greater sum of loanable capital; conversely, falling prices have the opposite effects, i. e., depress production and consumption, lessen the demand for capital, lower the Interest rate and lower the quantity of capital brought into existence by saving. Thus is it seen that the price of capital,—Interest, is not dependent upon the available quantity, but rather upon the relationship existing between its quantity and the demand for it.

Capital Costs—How Set

At this point we will consider how interest rates are set—in a qualitative sense, and a more exhaustive treatment will be accorded the subject later on. In general, the rate of Interest is determined—on the one side by the productivity of capital goods, and on

the other by the cost of saving and sacrifices. When the supply of capital exceeds the demand for it, Interest rates will fall, sometimes as low as one per cent, as in England during the latter part of the 19th century.

We have seen that the use of machinery and the extension of knowledge in industry creates a Demand for capital, and the supply of capital tends to set the rate of Interest, on the supply side of the question. At a two per cent interest rate, some little capital would be saved, at a four per cent rate there would be a greater saving, while an eight per cent rate would induce a still greater saving, thus creating a greater Supply of capital. On the Demand side of capital, the rate is set by the least profitable use to which the capital can be dedicated. If the interest rate were eight per cent, a few would borrow and many would lend; at six per cent, the borrowers and lenders might tend to equalize, while at four per cent there would appear more borrowers than lenders. Thus the rate of Interest appears at the point of equilibrium between the suppliers of capital and the users of capital. If the Interest rate should increase, then the supply of capital would increase because of the increased incentive to save, and at the same time the demand would diminish. Should the interest rate fall below the point of equilibrium, saving would be discouraged, enterprise stimulated and the rate would again tend to increase. In the final analysis, Interest is the price paid for a loan or use of wealth, which price is set—on the one side by marginal costs, and on the other by marginal utility.

(To be continued.)



Regaining Confidence Of American Investors

By WILLIAM W. BUTTS, M. A. I.

AMERICAN investors have lost confidence in real estate investments. In this convention city alone it is reported that several billion dollars have been lost outright. Real estate may not be alone in this regard, it is true. Railroads, industries, public utilities, and other fields of investment have also suffered as much and, in many cases, far more than real estate.

However, that does not relieve the Realtor and the real estate appraiser.

Our clients have lost money, lots of it. They are suffering as a consequence. They blame us regardless of blame. The innocent always suffer with the guilty and mostly on account of them. Our former customers point the finger of scorn at us. They say we misled them. They claim they bought real estate, real estate mortgages, and mortgage bonds because we recommended them. They dig up the old circulars with our appraisals and estimated earnings. They have the goods on us, that we must admit only in too many instances.

We may reply real estate will come back. We know it will. It always has and it will again. We know land and good improvements in the right location do not melt or run away. It is still there. It has not vanished. It is earning

something in spite of vacancies, broken leases, and unpaid rents.

On the other hand, fixed charges are nearly the same as five years ago. Taxes are only now being gradually reduced. Interest is at boom time rates. Insurance is higher. Special assessments for municipal improvements are still with us. Fortunately operating ex-

penses have responded to present prices, but reduced gross income is inadequate in hundreds of office buildings, apartments and hotels.

Residential properties are only somewhat better off. Many home owners have lost their invested income, their jobs, and their homes. Boom time prices are now too far below normal. The

government has been compelled to come to the rescue. The Home Loan Banks and still newer Home Loan funds are trying to serve as stop-gaps. But in many instances only too late. Building and Loan Companies, banks, and insurance companies have done what they can, but their ability to wait for repayments is limited also.

Enough of the sad picture. If we would be honest with ourselves now, we are not solely to blame any more

This paper by Mr. Butts touches on an important phase of the appraisal business. It calls attention to the feeling that many have as to the importance of architectural, construction, management, and engineering experience as well as real estate experience for proper valuation of real estate. This Institute has a committee headed by A. C. Houghton, M. A. I., of Washington, D. C., which is carrying on discussions with various other interests. An expression of opinion from the membership addressed to the President is desired.

— Philip W. Kniskern.

This paper was presented at a meeting of the Institute in the Stevens Hotel, Chicago, on June 14, 1933, by Clarence C. Lang of St. Louis.—Editor.

than those who promoted the properties and painted the fancy pictures. People are as over pessimistic today as they were optimistic a few years ago. On the other hand, we must admit many real estate men and certain so-called real estate appraisers are far from being blameless. Many of us know, and knew in the "good old boom days", of too many "curbstone" and "site unseen" so-called appraisals. I fear many mere telephone conversations were the basis of appraisals, which "checked" each other only too closely.

On the other hand, you members, and I know of many, many instances of painstaking efforts to get all available facts, make fair comparisons, survey the neighborhood, obtain costs and really produce as nearly sound appraisals as men of experience and integrity could humanly do. We all know that to err is human, and it is to minimize just such errors that this Institute was initiated.

This Institute has made a good start, is gradually accumulating the right kind of members, developing the right kind of policies, and is doing a worthwhile job. I am glad to pay my compliments to President Kniskern and Secretary Nelson for their continuous fair guidance. They are securing national commendation for us.

On the other hand, we must be frank enough to realize that others besides Realtors believe they are equally capable and experienced to make appraisals, particularly of buildings and construction projects.

The architects all over the country are appraising buildings, and point out the fact that poorly designed buildings with inefficient floor arrangement, improper location of elevator and other facilities, as well as waste of floor and window space are being appraised on cost or cubic content basis. Such procedure is discriminating against buildings better and more efficiently designed. They call attention to the fact that merely because a building is large

and is appraised on its size, does not necessarily justify itself; because a building more properly designed might serve the same purposes with considerably less volume.

Civil engineers are appraising buildings and structures and call special attention to substruction and foundation problems, structural design, floor loading, and other structural engineering features. Mechanical engineers are likewise making appraisals and point to the adequacy and efficiency of mechanical equipment including heating, elevators, lighting, plumbing, and the more modern problem of air conditioning. They also call attention to the fact that in apartments, office buildings, and hotels the mechanical costs may equal as much as one-third of the total, and the efficiency of the whole structure is dependent upon mechanical appliances.

City Planning Engineers are making appraisals. They accentuate the "location factors". They point out, and very properly so, that a project might be adequately appraised and yet be in the wrong part of the town. In such a case, even if it earned satisfactorily for a short period of time, it would very soon find itself in the wrong neighborhood. They call attention to zoning, environs, transit and transportation facilities, street widening, and other planning programs.

General contractors are making appraisals. They build buildings and, therefore, know the actual construction costs. They know how to make quantity surveys of all items in the structure and know what to include in the final determining of either the original or estimated cost of reproduction. As builders they know the quality of buildings and the condition of any particular structure at a given time and place.

Financial people are making appraisals. Mortgage investment bankers and fiscal agents of all kinds contend that they know the values of securities and the market therefor. They presume to know the cost of obtaining money, the trend of interest rates, and the best method of financing.

Building Managers are making appraisals. They are sure the way to make appraisals is on earning power, that regardless of location of land and structure if it does not earn sufficient to meet operating expenses, maintenance costs, interest payments and amortization, and have a profit remaining, the project is a failure and should never have been started.

If we wish to be recognized in this appraisal field, we must be equally frank to recognize the merits and abil-

ity of others. In truth, no single element of construction, real estate, or financial groups can justly claim sufficient universal knowledge and experience to make a complete fair appraisal of not only the value of land and structure, but the use or income factors pertaining thereto.

In order to create the structure originally, it took Realtors, constructors, financial agents, and managers to put the building on the map. The claim is made by each of these groups, therefore, that they should participate in the appraisal of such an enterprise. It would seem that there is merit in this contention and that we should cooperate with them.

No reliable member of the real estate, construction, or financial groups can reasonably condone careless, biased, or unsound appraisals. Appraising is recognized as an essential investigation of the various factors involved in a transaction having to do with land or improvements erected upon it.

With these various and divergent people and view-points working out related appraisal programs we face the hazard of getting the public all tangled up regarding the type and value of appraisals and also hazard the chances of getting the appraisers themselves into disrepute.

Mark Twain once said "everybody talked about the weather, but no one ever did anything about it." A fellow-townsmen of mine, A. P. Greensfelder, Past President of the Associated General Contractors of America, recently decided to do something about this situation. I will vouch for his integrity, unselfishness, and vision because I have cooperated with him on this matter and on various civic matters for a number of years.

He called a small informal luncheon in St. Louis about a month ago of rep-

resentatives of these various national groups and suggested that the way to obtain sound appraisals was to proceed along sound lines with sound-minded people and prepare a general form of a comprehensive consolidated appraisal.

This little group did roughly outline such a form. This form was submitted at a larger meeting recently called in Washington of national members of the various national associations which was unofficially held at the headquarters of the Chamber of Commerce of the United States who offered their neutral facilities for the use of this unofficial group. This Washington meeting included in addition to A. C. Houghton of Washington, D. C., member of our Institute, a President and two recent Past Presidents of the National Association of Building Owners and Managers; the President of the American Institute of Architects; the President of the Associated General Contractors of America; a member of the American Society of Civil Engineers; a member of the Society of Mechanical Engineers; A. J. Mertzke, Economist of the Federal Home Loan Bank Board; and F. S. Fitzpatrick, Manager of the Civic Development Department of the Chamber of Commerce of the United States.

This group unanimously agreed on two things; first, See that appraising was recognized in the Securities Act of 1933, known as H. R. 5480 which was then being acted upon by Congress; and secondly, to invite the Presidents of the various national associations, interested in appraisals and appraising problems, to appoint a representative and alternate to represent each respective association at a joint conference on appraisal practices.

Relative to the first matter, they found that the Securities Act of 1933 which has since been signed by the President and becomes a law:

In Section 7—"Information Required in Registered Statement"—mentions appraisers "as any person whose profession gives authority to a statement made by him or is named as having prepared or certified a report or valuation."

Section 8 (d) calls attention "to any untrue statement of a material fact or omission to state any material fact".

Section 10 (3) refers to prospectus and rules and regulations required therefor.

Section 11 (a) (4) refers to accountant, engineer, or appraiser, or any person whose profession gives authority to any statement made by him or as having prepared or certified any report or valuation which is used in connection with the registration statement in connection therewith.

Section 19 (a) gives the Federal Trade Commission among other things the authority "to prescribe the form or forms in which required information shall be set forth in the appraisal or valuation of assets or liabilities, in the determination of depreciation and depletion in the differentiation of recurring and non-recurring income, in the differentiation of investment and operating income".

Schedule A (21) of the Act requires that the purchase price of any property be stated.

All of this would indicate that appraising is not only recognized in the Act, but that only statements telling the truth, the whole truth and nothing but the truth by competent authorities will be tolerated, in connection with securities transmitted or sold in interstate commerce.

I understand that this group also very highly commended the technical research work and advance programs of our Institute and wished our Institute to know that they do not desire in any way to interfere with the work of the Institute, but merely to strengthen and broaden appraisal practices and consolidate the activities of the various national groups and to unify their programs so far as practical and thus expedite the return of American confidence in real estate investment securities.

This group also desires members of each National Association to realize that any person is at full liberty to employ any party in whom he has confidence to furnish the final Certificate of Appraisal. The person so selected would agree to call in and "captain" as it were, members of the various other professions whom he might select to determine the various factors in which they were respectively experienced and to whose statements as submitted, they would be willing to sign their own names.

Such procedure would leave members of our Institute as free to solicit business as they now are, but in order to obtain complete information, effect a consolidated report, and thus produce a comprehensive appraisal, we must recognize what the Courts are recognizing, namely, that appraisers should properly take into consideration three basic tests of values which are, Cost of Construction, Market Prices, and Earning Capacity upon which to determine the final figures.

Various national associations are studying and subscribing to other matters of vital interest to appraisers. The construction group has already drafted a uniform act for state legislation to license building appraisers patterned after similar law relative to certified public accountants.

Other problems include the setting up of Appraisal Bureaus in the large metropolitan centers from which could be drawn various appraising talent for particular projects. Another group envisioned the possibility of requiring "Permits of Necessity or Convenience" for construction projects for which subscriptions are to be collected from the public, similarly to the requirements of public utilities in most of our states.

In view of the various phases of the whole appraising problems it would

seem appropriate and wise for our Institute to express its willingness to cooperate with other national groups in all matters affecting appraisal problems and practices and I will therefore urge that our President be authorized to delegate representatives from our Institute to meet with other delegates similarly selected, and acquaint each other with the work of their respective national associations, avoid duplication of efforts and prevent conflicting actions, wherever possible. A suggest-

ed program for such a joint conference to my mind would be something like the following:

1. Prepare a statement as to just what constitutes a Comprehensive Appraisal;
2. Prepare a standardized form of Appraisal;
3. Outline a program of procedure for making appraisals;
4. A uniform law for Certified Building Appraisers;
5. Certificates of Necessity or Convenience.



Percentage of Cities Reporting Higher, Same or Lower Rentals of Central and Outlying Business Property as Compared with Same Date, 1932

Section and Size of City	Central			Outlying		
	Higher	Same	Lower	Higher	Same	Lower
Totals for United States and Canada.....	1	30	69	2	14	84
New England .....	....	38	62	....	20	80
Middle Atlantic	3	20	77	2	9	89
South Atlantic	4	26	70	7	13	80
East North Central .....	....	28	72	2	7	91
West North Central .....	....	33	67	....	11	89
East South Central .....	....	17	83	....	33	67
West South Central .....	....	36	64	6	27	67
Mountain .....	....	25	75	....	25	75
Pacific .....	....	46	54	....	20	80
Canada .....	....	....	100	....	....	100
Over 500,000 .....	....	11	89	....	10	90
200,000 to 500,000.....	....	20	80	5	16	79
100,000 to 200,000.....	....	24	76	....	10	90
25,000 to 100,000.....	....	31	69	3	10	87
Under 25,000	4	40	56	2	25	73
District and County Boards.....	....	28	72	....	10	90

—from Semi-Annual Survey, National Association of Real Estate Boards, July 23, 1933.

The Realtor Appraiser's Great Opportunity

By IVAN A. THORSON, M. A. I.

REAL estate is our oldest commodity, and still perhaps the one we know least about.

In its raw state it was handed us by nature as her gift,—as such we paid not a cent for it nor expended an ounce of energy to produce it. Land was here when man first came on the scene.

Ricardo and other early English economists persisted in claiming that land did not belong in the category of economic goods, although he had a hard time to explain what became of the expenditure of labor and capital on land to make it utilizable (still the Ricardian Rent Theory is in many respects basic. Urban land, however, was not much of a problem in Ricardo's time).

Whatever our theory may be in regard to land, whether it belongs in the category of economic goods or is simply nature's gift, to the first settlers in this country and to those who trekked westward later on, land *was* nature's gift pure and simple; it could be had for the taking.

The fact that land originally cost nothing, had no production cost, may account in a measure for our disposition to designate the *selling price* as the *cost* as well as the *value* of land. It took us some time to discover that the value we attempt to calculate in a real estate appraisal is not the "market value" of the economist. We still seem to have difficulty in separating *production cost* of a thing from the price some one may have paid for the thing.

With the machine age came cities.

Man power was transferred from farms to city factories. The factories returned to the farms machines which ploughed deeper, cultivated better, reaped and threshed much more thoroughly, and did so with very little expenditure of man and animal power. A greater production by far of farm products resulted.

Use Value and Speculative Value

Whatever it may have done to bring our present dilemma, this rapid growth of cities stimulated tremendously real estate activity, and while real estate previously had been dealt in both as a speculative item and as an investment, the selling and buying of real estate had been more or less of a haphazard affair, dabbled in by most anyone as a means of turning a penny. Up to this time the usual thing was for the manufacturer or merchant, whose business was rapidly expanding, to seek the owner of the land which he needed, and to dicker with him for the best price obtainable. It should be noted that land was mostly acquired for specific uses at this stage.

The merchants and industrialists were busy men those days, making and selling new things which men had long wished for and needed. So they were inclined to delegate the function of haggling for needed real estate to middle-men, usually their lawyers.

Opportunities for profit and speculation multiplied. Land which had cost the owners practically nothing was sold for large sums. A new type of middle-men arose who, acting on

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their own accord, entered the business of buying and selling real estate. They would induce land owners to part with their holdings to speculators who hoped to resell at a profit to those who had use for the land.

These speculators did not always find users to whom they could resell their purchases, so the middle-men, or brokers, conceived the idea of inducing a second set of speculators to buy from the first speculators, and thus a property would change hands a dozen times, not a single purchaser having any idea of putting it to use.

Naturally, under such a system, land values came largely to be based on resale possibilities, or on hypothetical uses which often never materialized.

If prices were out of line with these hypothetical uses, this would soon be remedied by the fact that there was a constant increase in the influx of people to the city, and a rapid and steady expansion of industries. It was like a young tree which was designated as being three feet in height, when in fact it was only one foot high. A few years later the guesser of the height of the tree would point to it and proudly commend his own vision, as the tree would then be four feet high.

This went on merrily with comparatively few casualties, so long as population and industry were rapidly expanding.

Control Shifts to Money

For the huge enterprises, which sprang up, whether sound developments or of a speculative nature, great sums were needed. Individuals and organizations commanding large sums of money were visibly peeved at seeing industry and brokers fatten on speculative profits. Why couldn't they participate? So we find the forming of bank affiliates and other organiza-

tions whose purpose it was to underwrite various real estate undertakings, many of them highly speculative. This was all right so long as they used their own money, but speculating with the life savings of others proved more or less disastrous.

Money now took charge and has held the reins until recently, when it collapsed on us very dramatically.

Because of the great industrial activity and the general prosperity of the country, accumulations of money and credits resulted far in excess of what was needed for the purchase of consumption goods, that is, for the normal requirements of our every day needs.

The surplus had to be invested somewhere. It found investment in capital goods,—that is, in more buildings, more machinery, more land. We were apparently assuming a continued influx of men and industries to the cities. Some of the surplus money also went abroad as foreign loans to finance production machinery, the output of which is now competing with our own goods. The belief that there could be no plethora of either capital or consumption goods was fanned by the old classic economy that men's wants could never be satisfied and there could be no such thing as overproduction.

Capital Goods and Unemployment

In the meantime, men aided by machinery, became increasingly efficient. Government statistics show that while the value of the manufactured output during the years from 1909 to 1929 increased by over 20 billions of dollars, the wages increased less than 12 billions, and the number of actual jobs remained about the same. Land also increased in efficiency—farm land produced more, and buildings of increasing heights were erected in the

cities. Besides, rapid transportation brought outlying districts closer in.

Still the classic economist may be theoretically correct when he says there can be no overproduction. The wage earners and the farmers will answer that if they are given sufficient wages and prices for their products they will see to it that there is no overproduction. It has been a characteristic of our classic economists to assume ideal and unchanging conditions,—a situation which unfortunately does not exist. Whether or not overproduction is possible, so far as consumption goods are concerned, we shall leave to the economists to struggle with. That there has been overproduction of capital goods, on the other hand, there can be little question. Whenever in prosperous times there are abnormal vacancies in multiple dwellings and in office buildings; when warehouses are half filled and a large part of the plant equipment lies idle, we can arrive at only one conclusion, that is, that there is overproduction of these capital investments. The disastrous effect of the overproduction of capital goods, and particularly of automatic machinery, was the creation of unemployment as noted above. When making this statement I fully realize that violent exception will be taken by the now thinning ranks of the orthodox economists. But, as Dr. Samuel Johnson said, "*Experience* becomes the test of truth and is perpetually contradicting the theories of men."

Speculative Selling Needs Rising Markets

Speculation thrives on a rising market. As the buying and selling of land has been largely on a speculative basis, a rising market has so far always brought with it a brisk real estate market at constantly rising price levels. Rarely was the question,

"How much will this property yield?" but, "What can it be resold for?"

In a falling market speculative selling of real estate all but ceases. As was expected, therefore, real estate would unfailingly freeze in a falling market, to thaw out and resume activity when the depression was over and prices generally began to rise. This has repeated itself with practically unfailing regularity during every depression and boom, so far, which has convinced the old-timers that now, that there are signs pointing to an emergence from our depression it will be only a matter of time until prices of real estate again will soar. They say that there always have been pessimists who had no faith in the revival of real estate, but that such pessimists were always discredited in the end.

There is both truth and untruth in such statements. However, it is not a matter of pessimism or optimism, nor should it be a matter of faith. One should not make a material investment on faith. Blind faith is almost always disastrous. The man who says he has faith in his ability to ford a river, the depth of which he does not know, may be an optimist, but he likely will be a dead optimist before long. Knowledge alone is the true basis of optimism.

However, several things have happened during the last twenty or thirty years which are changing the aspect of real estate, and which are greatly influencing land values, the increase of which admittedly depends on increase of population. The government passed an anti-immigration act. From an average of a million immigrants coming into this country every year from 1905 to 1914, we suffered actual loss by emigration during 1931-1932 of over 230,000 (according to Louis L. Dublin, President American Statistical Association). Besides, our birth rate has been materially affected.

The immigrants believed in large families; the average American seems to have a different idea, so that, statisticians tell us, it will be only a matter of a short time before population increase will cease altogether in the United States.

Furthermore, the census reports show, the growth of the downtown of practically every large city in the United States has come to a standstill. Present growth is confined to the outlying districts and satellite cities. The automobile, rapid transportation, and the subdivider have tended to that.

In our enthusiasm to supply what seemed an inexhaustible demand for industrial plants, warehouses, lofts, multiple dwellings, stores and office buildings we certainly must have worked under the theory that there could be no overproduction. We pushed forward construction projects with evident disregard of the fact that capital goods have no value except to the extent that they in turn can produce income. A great deal of this building was done without preliminary surveys as to the possibilities of fully utilizing the space thus produced.

Intangible Things Seem Hard to Grasp

We have learned to do the most astounding things; we fly through the air; we travel under seas; we skim over the surface of the earth with incredible speed; we have harnessed the ether; we split the atom and weighed the sun—and still we seem incapable of solving the intangible things that have to do with the human equation—that is, the things of a sociological and economic nature. We excel eminently in things that have to do with tangible things, with calculable forces and reactions, and with mathematics; but we seem to blunder atrociously in trying to calculate man's future actions around

which our economic problems revolve. Our efforts in this direction seem to resolve themselves into attempts definitely to measure mathematically and physically the products of labor, capital, and organization, regardless of whether such efforts and expenditures have resulted in adequately creating useful qualities in the material things on which we have expended such labor, capital, and organization. Thus we have calculated the number of square feet in an urban lot and the cubic feet in an apartment or office building, have multiplied these by certain monetary factors and have called it *value*.

So long as land prices were continually advancing, from whatever cause, our mistaken economics was not noticeable, but when things began to happen which had the tendency to force us back to fundamentals, we found that we have often reckoned without our host. An accumulation of ethical and economic mistakes throughout the world made the depression inevitable and finally overtook us in 1929,—by far the most severe in our history. According to Prof. Warren of Cornell (Forum, April, '33), in the first three and one-half years of the panic of 1873, which up to the present depression was the longest and perhaps our most severe, lasting as it did approximately six years, the prices of thirty basic commodities dropped 19%. In the first three years of this panic these same commodities dropped 51%.

Nowhere is the confusion of ideas more apparent than in the attempts to assign causes of, and remedies for, the depression. Of course, the limitations of this paper and of this speaker as well, preclude any extended comments on this. However, we might briefly remark that through the great perplexing and tumultuous confusion of ideas, the growing conviction seems

to be that unemployment was in a large measure brought about by excessive production capacity, manifesting itself *initially* in the overproduction of *capital* goods, causing unemployment in that industry, which, in turn, spread to the industries producing consumers' goods, causing additional unemployment, thus starting the vicious downward spiral.

Cost of Government Soars

In addition to the handicaps enumerated, we have had a constantly growing cost of government, resulting in making fixed charges against land, in many instances more than the possible net income. This has been emphasized by our fluctuating dollar, varying in value from approximately 55c in 1920 to \$1.80 in March, 1932, in terms of the 1926 dollar, which meant that a long-term loan contracted in 1920, if payable now, would call for payment, in terms of purchasing power, of approximately three times the amount borrowed. Our rubber dollar and iron debt have played havoc with farm and home ownership especially.

Our government, attempting to maintain our dollar with a gold content of 23.22 grains, regardless of what the rest of the world was doing, and regardless of the value of other commodities, has sponsored the most colossal case of price fixing the world has ever seen.

Furthermore, promising repayment in gold of some 150 billion dollars' worth of debts, including both governmental and domestic, when we possessed only about 4 billion dollars' worth of the yellow metal, was on the face of it a meaningless gesture. Which is worse, to make such a promise, or later to repudiate it, is something which will perhaps remain an open question for some time. What we are mainly interested in is the fact

that our artificially high value dollar has had a very disastrous effect on real estate prices. The action of the fluctuating dollar is generally not understood by those whom it most concerns. To the man on the street a dollar is a dollar, and he cannot understand that if he sells his property for \$1,000 now, which cost him \$1,500 in 1920, he is making an excellent profit, if the property has carried itself in the meantime.

The regime of *laissez faire*, rugged individualism, is evidently in the process of being modified. Instead of less government in business, we shall have to expect more government in business, whether we like it or not. There is no reason to believe that real estate operations will be excepted.

Trade associations are being called upon to help map out the new course. They will shoulder extremely responsible assignments.

We sincerely hope that the National Association of Real Estate Boards will be used as a vehicle through which our government will attempt to work out the many problems confronting the home owner and other real estate interests. Possibly we may have to convince the powers that be that we are still in the business.

Real Estate Brokers Today

The real estate business has gotten more or less out of hand during the past two or three years.

The banks and Mortgage Companies are the folks who are today doing the business we used to do.

How did the banks and the Mortgage Companies come to own so much real estate?—especially the banks, whom we have accused of being too conservative in their lending, and who, in the opinion of many brokers, by their refusal to grant adequate loans, have spoiled many a real estate deal?

Apartment house owners, as well as owners of other types of real estate, tell us that banks and Mortgage Companies are also ruining *their* business by quoting rental rates far below an owner's cost of operation, thus forcing more properties into receiverships and foreclosures.

The answer is a little hard to take, but in an assembly like this we should be permitted to "speak with the brutal frankness of blood relations," as Dr. Vincent used to say.

The obvious answer to the question, why we now have to struggle with competition from banks and Mortgage Companies, both in the selling and leasing end of our business, is that we have insisted on too high appraisal values. Improper appraisals of real estate have been almost universal. Speculative prices instead of warranted earning value have been the basis of real estate valuation.

Four things have contributed mainly to such incorrect valuation:

1. The belief that physical properties as such have value, and that the value is measured by the cost of reproduction or by what some one paid for the properties.
2. Easy money and misplaced confidence.
3. Lack of proper data as to possible absorption rate of the various kinds of real estate development.
4. Absence of adequate checks on the merchandiser or seller of real estate.

Position of Ethical Broker Difficult

The position of the ethical Realtor has been a difficult one. Let no one believe that the course of events, as above indicated, took place without numerous protests and misgivings on the part of constructive and far-seeing Realtors. However, many of the mistakes were not made wilfully. It was to a large extent the lack of proper understanding of the fundamentals which underlie real estate values. We

naturally and as a matter of course, applied to real estate the knowledge we had gained through our experience and contact with ordinary commodities, not realizing that real estate had many characteristics which set it apart from other commodities and which necessitated in many respects a different treatment.

Furthermore, the ethical real estate operator was practically ignored by the politicians who have had, and still have, to a great extent control of the larger part of the appraising business in connection with condemnation and other appraising under the jurisdiction of the municipality. The wild and ridiculous appraisals made by these political and curbstone appraisers, who always claim to be real estate experts, have perhaps done more than any one thing to discredit real estate in the eyes of the public.

Real estate study is still very young. On a rising market it was not necessary to know much about fundamental values, and as long as the real estate business was done largely on a speculative basis, and selling prices, that is, the so-called "market values," were accepted as values there was in fact very little need or place for the scientific appraiser, who maintained that the proper basis of real estate investment was its warranted value predicated on its earning power. No appraiser is needed to establish "market value" in the sense that it is used by the economist, as market value is a price, either well known or easily ascertainable. No one would think of employing an appraiser to learn the price of bread, razor blades, or hats; or to ascertain the market value of General Motors. The real basis of land values is one of the many things that we have not thoroughly looked into and is now, when relations have become strained, rising up to bother us.

The Scientifically Trained Appraiser

As we were beginning to see the dire results of our orgy in land speculation, there was impressed on us the imperative necessity of seeking warranted, justifiable real estate values, on which sound investments could be based. Realtors and others began to study the economics of land values. Here we have further learned that Adam Smith's so-called immutable economic laws were mere tendencies which should be accepted in a statistical sense only: that human behavior is subject to mass laws only. Because human actions and reactions appeared under certain circumstances to possess an aspect of continuity, we had erroneously labeled them laws—sociological or economic laws. There was also the tendency to assume that these so-called laws would affect real estate in the same manner as they affected other commodities. The depression has been to the study of land economics what the World War was to airplanes. It has rapidly and ruthlessly weeded out the false from the true, and we are beginning to see things in their right perspective.

We owe a great deal to the pioneers in this work, and although the intensive study of modern land economics covers only about a half score of years, this orderly study of land values has crystallized in the formation of the American Institute of Real Estate Appraisers, a development which all of us have watched with a great deal of interest, as it, without doubt, marks an epoch in the real estate business. If this Institute continues to develop as it has started, it will form the balance wheel in the entire real estate profession, and I am certain that the ethical and constructive broker will heartily welcome their entrance into the real estate field, not as an adjunct to the brokerage business, but as an independent force which will act as a

wholesome check on tendencies which have all but disrupted the real estate business.

Cooperation Should Be the Watch Word

The broker has everything to gain by close cooperation with the ethical and skilled appraiser. An owner does not like to be told by the broker that his price is too high. The broker can escape antagonizing the owner by the employment of an appraiser to make the set-up. It is, furthermore, likely to get him a price at which the property can be sold. The broker can then devote his time to the business of selling with a better prospect of being successful, not to mention that it is the fair thing to the buyer, who will feel that his interests are being protected. In the real estate business alone, no adequate check has been provided on the seller. The real estate broker has so far been both advocate and judge.

There is one thing I have never been able to make out; that is, why brokers generally seem so anxious to uphold the owner's idea of selling prices as against the real warranted values. It makes property harder to sell. Furthermore, if a sale is made at the high price, the new owner will not have an adequate income, and is likely to join the ranks of the dissatisfied.

How about being both a broker and an appraiser? Many excellent brokers are also first-class appraisers, and an appraiser certainly can capitalize on the general knowledge of real estate gained as a broker, but it is the speaker's contention that one cannot ethically act as both an appraiser and a broker on the same job. An ethical engineer will not act in the capacity of both contractor and engineer on the same job.

It is feared by many outstanding brokers that failure to separate the

function of appraiser and broker will cause the springing up of a group of self-styled advisers posing as protectors of investors in real estate or of real estate securities, who will be a menace to both the brokers and to the public.

It is not intended that the real estate appraiser should usurp or encroach on the business of the engineer, architect, builder, contractor, accountant, lender, city planner, property manager, or broker. Quite the contrary; but it is essential that he cooperate with all these agencies and that these agencies in turn should cooperate with him, as well as with each other. The successful working out of our present economic dilemma will largely be dependent upon to what extent general social integration takes place.

I believe that most of us who are acting in the capacity of both broker and appraiser are finding it increasingly difficult to do so, as the necessary judicial attitude required in an appraiser is more or less antagonistic to the vigorous enthusiasm required in a salesman. Of course there are outstanding exceptions. We all know real estate brokers who never let their desire to earn a commission run away with their better judgment. But we do not build systems nor lay down rules for the exceptions.

Prices Not Likely to Advance Materially

The present situation will no doubt call a halt on real estate speculations, but as soon as people get their bearings again they will place their money where there is safety of principal and certainty of return. This does not mean in residential or other vacant property bought for re-sale. It does not mean buying bonds, the security back of which are merely buildings or plants. These investments must be based on

essential services to communities and to society in general. A proper mortgage, or other real estate security is merely capitalized income. There are still some 40 billions on deposit with banks, a good deal of it awaiting safe investment.

While the change in the value of the dollar, in line with the inflationary program of the Administration, will to some extent be reflected in higher real estate prices and rentals, the actual increase in land values, generally speaking, will perhaps not be very pronounced. Land valued on a basis of what it will yield,—will in not a few instances suffer still further deflation.

There will undoubtedly be uninformed brokers who will attempt to convince their clients that the old booms will be reenacted, thus delaying sound recovery.

Responsibility of the Appraiser

Securities issues, whether secured by real estate or otherwise, will in the future be under strict government scrutiny, and while there can be no guarantee against mistaken judgment, preventable mistakes in judgment must be guarded against. An entirely different system of appraising than has heretofore obtained will be demanded. There is no gainsaying that most of the appraisals on which real estate securities issues have been based have been outright farces. I believe and earnestly advocate that the appraiser's name should be placed on the bonds which are secured by the appraised real estate. Only in this way can we definitely locate responsibility. The name of the engineer or architect who plans a bridge, or skyscraper must appear on the plans, and if the structure fails, it carries with it the engineer or architect (since this paragraph was written I note that the Securities Act now demands that the ap-

praiser be held personally responsible for his appraisal).

Functions of the Realtor Appraiser

The able, trained appraiser is going to be a very busy man the next few years. Practically the entire world has to be re-valued. To mention only a few of the expanding functions awaiting the attention of the Realtor-appraiser, we are listing the following:

1. To revalue whole city and farm areas for new tax bases, as well as to ascertain revised selling and rental values.
2. Scale down capital structure of industry. This will involve the appraisal of land, building, and equipment, and should be undertaken in conjunction with financial analysts and engineers.
3. Ascertain real estate losses for use in connection with income tax reports.
4. Calculate percentage of gross sales which various lines of business can afford to pay as rent. Because of the almost certain deflation in the purchasing power of the dollar, percentage leases will for some time be increasingly used, such leases being under the circumstances especially desirable from the lessor's standpoint. Lessees have favored percentage leases. Otherwise advise as to proper type and length of lease which would be most profitably made at this time.
5. Revalue the numerous properties which have changed hands through foreclosure proceedings during the depression, so that books may be properly set up. In many cases this should be done in conjunction with accountants or accounting firms.
6. Make surveys of blighted districts with the view of ascertaining to what extent renovation can profitably be undertaken.
7. Act as adviser to owners who may contemplate building, as to possible competition, suitability of location for specific uses, furnishing pertinent data as to trade or occupancy possibilities, whether same would be sufficient to warrant new building. Also advise as to type and extent of building which would have probability of success. Advise also generally as to best use or disposition of your client's real estate holdings. Important because of evident permanent surplus in some lines.

8. Intensive study of vacant areas with view to recommending best possible uses. (There is likely to be a still lower price on vegetables as a result.)

9. Cooperate with city planners with view to replanning smaller cities and outlying districts of larger cities. With comparatively small expenditure many cities may be made more accessible and future illogical growth prevented. The city planner is a definite and very constructive force in land economics.

Because of the situation in regard to population growth, greater individual efficiency, the decided tendency of industry to relocate itself away from the large centers, and because of Roosevelt's "Back to the Farm" program which articulates with this tendency, we are without doubt faced with a permanent surplus of office, store, warehouse, and loft space in our large cities. Just what percentage of vacancy there will be in each of these uses will depend on many things, and invites immediate and careful study. This will present another large field of operation for the Realtor appraiser.

I know that many very sincere Realtors believe that, as everything is now pointing to recovery, real estate will soon "come into its own" and prices again will soar. I have tried to point out in the above why the old course of events is not likely to be re-enacted. Let us not forget that the slump in real estate activity, meaning the selling and buying of real estate, came long before the depression.

Farms went bad in the early 20's when everything else was booming. The farmer thought war prices were normal prices, and loaded up with more land, more machinery, and more mortgages when a dollar's worth of debt could be paid off with one bushel of wheat, or less. However, he found that it would take $1\frac{3}{4}$ bushels to pay that dollar debt in 1922, and over $3\frac{1}{2}$ bushels to pay every dollar's worth of debt in early 1933. No wonder farms and farmers collapsed.

The term *normal* is a curious one. It is usually what wishful thinking wants it to be.

If we shoot 75 in golf, that, in our own minds, becomes our *normal* game. Whenever we shoot above that, we are off our game, although our average score is above 85. Conditions are seldom normal. Take a look at Babson's normal line in his Babson-chart and note how long our business activities keep on the line—about one day in the year; the rest of the time we are either above or below the line. Economics affairs are that way—they are dependent on human behavior which, like history, never repeat themselves *exactly*.

Urban Land

Urban real estate transactions became slow in or about 1926. We must not be confused by reports taken from the records of Title Companies or Trust Companies, where transfers brought about by foreclosures and by forced assignments read the same as bona fide sales.

The 1929 collapse simply intensified a condition already existing in the real estate field.

But why bring all these things up now—haven't we trouble enough as it is?

To cure an ill, we must know what it is. A doctor who would diagnose diphtheria as merely a cold to save the feelings of the family would be regarded as highly unethical. Sticking his head in the sand has saved no ostrich from capture. It strikes me that we have indulged in cheerful idiocy long enough. It is time to look things squarely in the face and call a spade a spade, with a view to right things at the earliest possible moment.

Real Estate Ready to Do Its Part

Real Estate always stands ready to yield its utmost, but we must understand its limitations as well as its possibilities. If we buy a

small horse on the strength of a statement made by the salesman that the horse can pull a hundred tons, which of course he cannot do, it is not the fault of the horse.

So when we expect real estate to produce many times its highest capacity, we are going to be disappointed; but we should not blame real estate, because of our failure to know its limitations.

Is it not time that we get over the idea that telling the truth about real estate is detrimental to it? **No type of investment can stand the truth better than real estate.** However, in order to tell the truth we must know the truth.

There are places in Europe where a man may sell his real estate at any moment at a discount of not over 10 per cent from the price he paid for it. A general acceptance of sound appraisal practice must of necessity precede such a situation, and this involves the education of the general public of what constitutes sound values.

Land values are not something which can be created by conversation or through wishful thinking. We can not repeat too often that the value of any project is the value of its services. These services may be in the form of money, amenities, or business profits, and it is the function of the appraiser to calculate in terms of money the value of the right to these services. To do this with some degree of accuracy requires skill much beyond that possessed by the average seller of real estate. I say this, knowing full well that many of our Realtors have qualified themselves fully to discharge the functions of a skilled appraiser. Such Realtors will agree with my statements.

Specialized knowledge, broad sympathies, and friendly co-operation with all agencies in the same field will alone bring about the desired result.

The whole problem centers around proper valuations. It is the Realtor appraiser's great opportunity to be of service to the real estate profession and to the millions who are anxious to invest in Mother Earth when they feel certain that they will be truthfully and ably advised.

Discussion

Mr. H. J. Brachman (Detroit, Mich.): There was one point that Mr. Thorson mentioned that I think we should take cognizance of,—political appraisals. We find in every community—that in Probate Court, and every other kind of action, they call in a friend of the judge to be the appraiser. It is unfair to Realtors; it is unfair to the parties who are concerned in the particular court action, whether it be condemnation, whether it be probate, or whether it be a civil suit. I think that if the Institute has not gone on record they should so do to bring that fact to the attention of our jurists.

Mr. Thorson said that use determines value. Use determines the value of anything. If we buy anything, regardless of how cheap it is, and can't use it or dispose of it at a profit, it is dead expense.

Mr. Thorson: The market value, as it appears in our newspaper columns, is an entirely different value from that we are trying to get in an appraisal. We have been saddled down with an inadequate concept of market value, and we haven't really known, the courts haven't known. Oranges in California today sell at five cents a dozen, or three cents a dozen. That is the market price. That is not the warranted value. The market value of some of our property is way down. That is not the value we are trying to ascertain in an appraisal. We are trying to get the warranted use value. At least, we are trying finally to settle on that after fiddling around a lot.

Unfortunately, in our definition of market value in the Standards of Practice we have tried very hard to combine the two. I don't think we have got away with it. If you will take that definition you will find that the first part defines market value and the last part the warranted, or use, value.

If you remember and keep in mind the definition of production, which is the creating of useful qualities in material things, you have the answer to the whole thing. Just to the extent that we have created useful qualities in material things, whether it be apartments, office buildings, or what, to just that extent have we created value. Capital, labor, and organization do not necessarily create value.

Some economists state that labor creates value. If you have a stone pile here and you put labor to work and move that stone pile over there, and then move it back again, you have expended labor, you may have had organization, but you haven't created any useful qualities by the moving. The buyer of the stone pile is going to disregard that entirely. The insurance companies are still foolish enough to insure on that basis, so they are buying a lot of buildings these days. After while they will tumble to the fact that they had better insure on a value basis, and they had better do it now.

The engineer is just concerned with one thing: Is that bridge over there built according to specifications? Will it carry the load? After we are in charge, whatever we do with it is none of his business. He doesn't know whether it is going to be a toll bridge or what it is going to be. And so the engineer and constructionist who build your office building are going to build it according to specifications, but what we earn from it is none of their concern. That is where we step in. That is all our concern. Why bother about this cost business? Get your engineer. If the cubic feet or square feet are the things, get the carpenters. Let them do that figuring. We have a much more important, much more difficult job to perform.

Now, just a word about forecasting income. I never could see that, for there is one important thing involved

—the fluctuation of the dollar, that is always in the way of making any forecast. We could buy three times as much of the necessities of life in March of this year as we could in 1920 with the dollar, and if you tried in 1920 to forecast the dollars per year that you would get from a certain building it was bound to be wrong in 1933, because rents fluctuate up and down largely with the value of the dollar.

I have been on appraisals where I attempted to do that in 1920. I predicted for 1933 an income of \$1,200 per month. The income is less than \$400 and it is going down, because the district is no longer desirable.

Well, what would you do to take its place? Just this: I divide all properties into three groups, those with an enhancing value, if there are any (there are some in the city's direction of growth, as a rule); those with a stabilized income, with a slight tendency downward in the heart of the city, for instance; and those with a decided dip or deflection in their income. To that class belongs all residential property, whether single or multiple. They have their highest value just when completed, and then start going down.

Another thing, residential property is a non-enhancing property. An apartment built for 100 will hold 100 and no more, while a new business location may serve 100 customers the first month and 1,000 in a year or two. There is where you get the ascending curve.

Then you capitalize the three according to whether you think the value is going down, staying steady, or will go up. If I am satisfied that the values will go up, as I am pretty certain in a coming district, I can capitalize at 4.5% or 5% and feel perfectly safe; while I never capitalize an apartment in my own appraisal at less than

12% net for the building, hoping to have a steady, reasonable, clear return of 6% during the life of that apartment.

Now then, if I have an apartment I have already allocated that to the type that has a descending income. All right; that means it has to have a high rate of capitalization. I would take what I think is as nearly as I can find the average return at the present time. I can't see into the future. I have never been able to do it. But I know that the net income is going to fall as years go on. So I capitalize at a rate representing the risk. Uncertainty is a risk.

Ask somebody to loan you 100% on that apartment. Will he do it? He will probably take a 6% mortgage on 50% of it. On the next quarter he would want twelve per cent, and if you can discount the last quarter at twenty-five per cent you are lucky. That is an average of twelve per cent, and he has less risk than the owner, because the lender has not only the building as security but he has the integrity of the owner as well, and he has no management trouble. Why should an owner be satisfied with less than the lender in that case? You will find that same lender going into a new district where you can see a town growing up, where he knows very soon that the land will be worth a good deal more, and he will let you have money on the whole thing at six per cent. That's different.

I don't know of any apartment over twenty-five years old that is earning money. During that time you have to get your money back from it. But what about your furniture and so forth? You have to renew the furniture at least three times during the life of the apartment and you may have tenants that will ruin it in three years. The average is six or seven; it may last twelve.

I never give the furniture a risk fac-

tor of less than twelve per cent. I have to get my money back during those seven or eight years, but I want twelve per cent, at least, or fourteen or fifteen, on my investment in the furniture, besides charging it off during the period of its life.

There is the twelve per cent return on the apartment; there is twelve or fifteen per cent on the furniture; then there is your refrigeration—a new one every five years and a high rate of interest, of course. Then the heating plant. It has to be renewed every so often. So, not only have I the 12% on the apartment, 15% on the furniture, 10% on the refrigeration, another 10% on the heating plant, and so on, but all that has to be earned before I get a dime, because my return is in the probable 6% I can save on the whole thing.

What about the land? The Ricardian Theory works only provided we have 100% efficiency. While it will work in about fifteen per cent of the cases the rest of the time it will not. Where the land is not properly improved why should we penalize the land? So I find what the land around the property is earning. Why should the land bear the brunt of the man's stupidity who put up the building?

If you check your apartments you will find that between eighty and ninety per cent of all apartments have gone broke. Furthermore, land under a building, like an apartment, always goes down with the apartment unless it changes use. There is no such thing as the land going up and the building going down, except, of course, in high-power sections. There the building is immaterial, it is a side issue. You will find on high-powered streets a one or two story building giving a wonderful return. You don't know how old the buildings are: you don't care. It is the land that is the big idea.

I don't know of any office building

that has lasted over forty years. You may; I don't. It isn't the physical depreciation. Some of our steel and concrete constructed buildings would last 500 years, but the use value has disappeared by the end of forty years.

We will find, I am afraid, that our entire level of real estate appraising is about up here (indicating) when it should be down there. In the heart of town, we are closest to the right values. The minute we get to the outskirts we begin to falter. It is unmistakable that the downtown section of any great city has had its growth. Los Angeles is growing tremendously in the outskirts, but downtown we quit six years ago. I had occasion to make an appraisal recently where the weighted center of the downtown had to be located. It has moved back about to where it was in 1912. You can see this in all great cities. You will find the rim of the downtown getting a little scraggly, with vacant stores, et cetera.

There is a general tendency for stores at the rim of the metropolitan center to move in toward the center, and this tendency is likely to continue as merchandising requires less space because of greater efficiency in handling, due largely to the increased use of package goods. Furthermore, this standardization of merchandise and of price has placed the stores in the outlying districts to a large extent on a par with the downtown stores.

We are without doubt faced with a permanent office building vacancy. What are we going to do? I have talked to a number of folk and they seem to agree on this, that we will have to persuade the owners of some of the less desirable office buildings to put them out of the market, make lofts out of them or subsidize them to some extent, otherwise that excess space will always be a competitive factor to reckon with. We will have to get it out of the way, just as

Secretary Wallace is trying to get the 50,000,000 surplus acres of wheat out of the way in agriculture. We are going to have a surplus in lofts, warehouses, and, I am pretty certain, in hotels. We surely already have it in store space.

Mr. Hooker: The first gentleman who spoke, from Detroit, mentioned real estate as a commodity. That seems to be a rather general term. I had occasion to look into that matter the other day. The dictionary defines a commodity as "something movable that can be bought and sold", and real estate is immovable, and therein lies the difference. There is another great fundamental difference between what we ordinarily term commodities or goods, and real estate, and that is that most goods are perishable, they have a comparatively short life. They get shopworn. Take, for instance, automobile tires. I understand that an automobile tire, even if it isn't used at all for two or three years, isn't any good anyway, but when you put a piece of real estate up it stands for forty years. Generally speaking, the surplus of goods will be absorbed in a very few years. People tell me that this country is going to run into a shortage of goods before long. The depression has gone on for three and one-half years. Buying will have to start again just as soon as even a few people get work. That will start manufacturing again.

However, we have certainly got plenty of real estate. The official figures of the National Association of Building Owners and Managers, to go back to office buildings, state that the average vacancy in office buildings as of January 1, 1933, was 24.29%, and I just got the figures for the May 1 report, and it is up to 26.87%. In other words, in the first four months of this year the vacancy in office space has increased in the forty-odd cities

reporting, which include all the large cities of the country and a good many of the smaller ones, by 2.58%. I agree very thoroughly with Mr. Thorson, that for some time we are going to have a surplus of office space. How long it is going to take to absorb that I don't know, but I don't see how it is going to be absorbed until the country grows up to it. I think it can only be absorbed by growth in population. Due to our optimistic financial methods of the past few years, we have that vacancy in office space to reckon with.

Mr. Slonim: I merely want to discuss very briefly the question of the forecast of rents. Mr. Thorson challenged what we thought was pretty much accepted by this Institute and by appraisers generally not connected with the Association. We began to feel that the proper thing to do was to make a forecast of future rents, future net rents, and to capitalize it to find the value. Let's analyze very briefly Mr. Thorson's point of view. He seems to take the present rental and to capitalize that. First of all, to take the present rental is very dangerous. In times of depression it is unfair to property; in times of a boom it is unfair to the purchaser. It doesn't create the right sort of conclusion.

I want to go further and state that there is no such thing as appraising real estate on the basis of net income without setting a future rental. What Mr. Thorson is going to do, most likely, is to claim that the present rental is the future rental. Isn't that, in the last analysis, what he does? He is capitalizing a certain fixed present rental, and while he tells us that he doesn't want to deal with a forecast, he is predicting that the present rental will be the future rental.

Now, then, there is a great deal of danger in the whole business. I mean by that that we can never arrive at one hundred per cent accurate ap-

praisals. We will never have mathematically scientific appraisals. That is impossible. There is too much speculation; there is too much uncertainty; there are too many factors that enter into it. But it is all a relative proposition. We are circumscribing the zone of mistake and error and I believe that it is proper to make a forecast of future rents. We judge by the audits of the past, by the experience of the building; we judge by many, many conditions—and we make a guess. I think it is proper to guess, within limits. I don't think any appraiser should set down what a building should do forty years from now, or thirty years from now. That is going too far. But I think it is proper for an appraiser to say that during the next ten years, or fifteen years, this building might do thus and so.

Mr. Thorson says that because money values change you can't predict the future value of real estate. Let's analyze what you mean by the change of money values. Your standard of measurement changes. The actual value doesn't change, necessarily. If all commodities drop from one level to another, there has actually been no change. If the basic commodities shift together, there has been no actual change in value.

Mr. Thorson said that if you bought a piece of property in '21 for \$15,000 and sold it today for \$10,000 you had lost no money, because \$10,000 today is better than \$15,000 was in '21. That is exactly my point. Let's not be afraid of monetary changes. Let's consider them. Of course we have to deal with the changes of monetary values; but I believe we have a right to make a forecast of rents because that seems to be the lesser of all the evils.

The only criticism that I can find of this whole system is that our apprais-

ers are apt to become technical and too cocksure. We have to approach that matter with humility. We are going to make a great many mistakes in spite of all the scientific study we make, because the data are wherein we will make our mistakes. But in a general way, realizing that we are going to make some errors, the least of all the evils is to forecast the rentals and to capitalize them conservatively.

Mr. Thorson: If we can measure rents in commodities, okay. If we use the price index of 800 commodities—the Fisher theory—I would have no objection in trying to forecast rents; but we are using a greatly fluctuating standard, the dollar, which has fluctuated from 55 to 180 in the course of about twelve years.

Here is an illustration: Supposing you went to a merchant and you wanted to buy some stuff sold by the pound, and he proceeded to give you a pound that measured 6.6 ounces. Then you want to sell him something, and immediately he takes another scale, which weighs twenty-one ounces to the pound. You would say he had a dishonest scale. Yet that is the exact relation between the value of the dollar of 1920 and of March, 1933. That is why I say we can not use dollars to predict with.

Mr. Kuehnle: If 12% is the proper rate of capitalizing the income on apartment buildings, then we won't have to worry very much about the physical value of the building, because there won't be any building value left.

Mr. Thorson's point that rentals can not be predicted in the future raises another rather interesting point that Babcock brought out in his new book. He qualifies his statement of future rentals in a way that it has never been qualified before in any

other statement that I have ever heard. He says that the prediction of future rents really doesn't mean a thing, that the prediction of value as these predicted rents are carried out doesn't mean anything. But this prediction of value is based on the present worth of the rentals as seen through the eyes of today. He makes that exact point. Therefore, I also believe that we are putting a value on the property today; we are not putting a value on anything in the future. The only thing we are doing in predicting future rentals is

predicting what the future rentals are going to be. If the commodity index is cut in half, future rentals might be cut in half.

Chairman Hall: The important thing is that we are all thinking. We realize that those conditions do exist and there should be some method of measuring them. By continuous discussion of this kind we shall eventually arrive at a unanimity of thinking. We never will be 100% in agreement, but we will arrive a little closer to the end toward which we are all striving.



Percentage of Cities Reporting Higher, Same or Lower Rents in Central and Outlying Office Buildings as Compared with Same Date, 1932

Section and Size of City	Central			Outlying		
	Higher	Same	Lower	Higher	Same	Lower
Totals for United States and Canada.....	....*	16	84	....	23	77
New England	23	77	....	33	67
Middle Atlantic	16	84	....	15	85
South Atlantic	23	77	....	24	76
East North Central	8	92	2	13	85
West North Central	11	89	....	22	78
East South Central	17	83	....	50	50
West South Central	33	67	....	40	60
Mountain	17	83	....	58	42
Pacific	3	14	83	....	21	79
Canada	100	....	....	100
Over 500,000	11	89	....	....	100
200,000 to 500,000.....	5	10	85	....	20	80
100,000 to 200,000.....	17	83	....	19	81
25,000 to 100,000.....	15	85	....	25	75
Under 25,000	19	81	....	33	67
District and County Boards.....	14	86	....	87	13

*Less than 1%.

—from Semi-Annual Survey, National Association of Real Estate Boards, July 23, 1933.

An Appraisal Of An Appraiser's Proposals

By ROY J. BURROUGHS

THE January, 1933 issue of The Journal of the American Institute of Real Estate Appraisers (Vol. I, No. 2) presents a thought provoking article entitled the "Relation of Value to the Purpose of the Appraisal".* But apparently this is scarcely the purpose of the article as the issue raised by the title is largely dismissed with this brief comment in an introductory paragraph,

Unless the concept **value** varies with the type of appraisal, I cannot see why the purpose of the appraisal should have anything to do with the eventual conclusion arrived at as to what the warranted present worth of the appraised property should be (p. 104).

Despite this slight lapse of purpose, the article immediately sets forth the important thesis that cost does not set the value of real property. This thesis cannot be over-emphasized during this transitional period in American appraisal practice. The next point made is of equal importance, that market price cannot be accepted as a reliable criterion of value (p. 106-7).

A valid concept concerning the value of real estate is expressed as the "Present worth of future net income" (p. 110), using income in its broadest sense to cover both cash and amenity returns. It has long since been shown that the earnings from "sunk capital" such as improvements on land or other instruments of production are similar in their nature to the rent of land being determined entirely by the demand for the capital good during its economic existence. Irving Fisher has probably presented the clearest argument to show that the capital value of such capital goods or of land is the discounted worth of future earnings.¹

It is well that this idea be re-emphasized time and again.

Indeed it is re-stated in the JOURNAL in an understandable and laudable fashion as follows,

An appraisal, based on economic fundamentals, may be defined as the process of calculating the **value of an ownership**, or right to enjoy the benefits accruing from the thing owned. An appraisal is also used to designate the reproduction or **replacement cost** of the physical belongings to the owner. The former may be designated as an appraisal to determine value and the latter as an appraisal to determine replacement **cost**, as when we appraise for insurance risks (p. 110-111).

This is fine—is absolutely true. Incidentally, the suggestion that these two different purposes of appraisals give different results sounds like a discussion of the subject mentioned in the title.

Were this an academic journal one might be justified in making some minor criticisms of the article's interpretation of Ricardian rent doctrine, and the discussion of economic law. But the practical appraisal problem is the matter of common interest here. It is in the practical application of theories that the article becomes untenable.

Concerning the practical appraisal problem, it is highly questionable whether either simplicity or an approach to accuracy is attained by the assumption that,

Instead, therefore, of attempting in an appraisal of real property to estimate and to designate in dollars the **future income spread**, we may obtain approximately the

*Thorson, Ivan A.

¹Fisher, Irving, *The Theory of Interest*, N. Y., 1932.

same results by estimating from all available data the probable hazards incident to ownership of the particular property under consideration, and reflect such hazards in our capitalization of the present warranted net earnings from the property, using a rate percent reflecting the estimated future risks. The two methods are in principle the same, but one is easier and simpler of practical application.

The fallacy of using *present income* as a basis of predicting value is exploded by one authority as follows:

While earning expectancy may be close to the present rate of earning for a number of years it is certain and inevitable that the flow of income will be different toward the end of the useful life of the building. It cannot but somewhat increase the accuracy of the valuation to try to predict these future changes, even though the possibility of doing so in any very precise manner is manifestly impossible.²

This authority presents tables to permit the calculation of the present worth of several different types of declining and stabilized income distributions over the life of properties. Hence the use of present income as the basis is no longer an advantageous shortcut.

The two methods are not in principle the same; far from it. One knows what the present income is. One knows that in all probability the income stream of the future will be a declining one. The extent of the decline, the period of the most rapid decline, or in other words the amount of the future income at different periods in the life of the property, can be estimated for each different class of property with some degree of certainty. The risks involved are that the particular property being appraised will not be a typical one; or that the typical case will change; or that some significant elements of facts have been overlooked in the attempt to estimate the future. Stated in a different way, there are risks peculiar to a given property because of the location, the character of

management, etc. These risks may set off given property from a typical property of the same use type. Then again certain use types belong in the category of hazardous industries. Either the cash earnings or the amenities to be derived from certain use types varies greatly with the rate of obsolescence, with the changing demands of the buying or consuming public, and with general business conditions. And finally, even appraisers are mortal. They may be mistaken in the selection or use of data, or be unable to obtain important facts bearing on any particular case. All these items enter into the risk elements included in the rate of interest. The present worth of a declining income, which is estimated to decline at some known and predetermined rate, may be calculated in the light of all the risks involved. All available facts are assembled and a judgment reached which seems reasonable in view of the facts.

The attempt to use the present income only as a base for capitalization seems to evade the issue entirely. Value is the present worth of future income. If future income is going to be different from present income, then present income is but one small datum in the calculation of value. The present worth of present income is the amount of that present income. But the present worth of future incomes is something less than those future incomes. The present income is of no significance for future uses, except as it permits one to prognosticate what future earnings will be. It merely provides a starting point. Income may rise for a few years in a new property and then decline. The use of present income as a basis for capitalization takes neither account of the possible increase of earning of a new property until it reaches normal occupancy, nor does it take account of the certain de-

²Babcock, Frederick M., *The Valuation of Real Estate*, N. Y., 1932, p. 229.

cline of those earnings over a period of years thereafter.

The use of the phrase "warranted net earnings" above quoted seems to be a euphonious expression for avoiding the use of mental processes. The implication seems to be that such net earnings as obtain at present may be certain to obtain in the future, but that there are some risks that such will not be the case. But as a matter of fact, an appraiser is usually perfectly safe in warranting, guaranteeing, and assuring, the one desiring the appraisal that the present net earnings will not continue in the future.

The next questionable procedure is involved in the attempt to impute a portion of the earnings to each separate minor element of the property and to use a separate capitalization rate for each. So far as the selection of a capitalization rate reflecting risk is concerned, the more secured parts of the income stream may be assumed to rest on the land or be imputed to the land. The next may be assumed to be imputed to the building; and the last or least secure to the equipment. But for practical purposes, this three fold classification seems sufficient. To the land itself is ordinarily imputed the most certain stream of earnings because it has, as a rule, an earning power in various alternative uses. The earnings ascribed to equipment are probably less secure than those ascribed to the building because of the more uncertainty surrounding the obsolescence of the equipment. But having gone thus far in the stratification of the income stream into three layers based on risk, it seems like straining a good idea too far to impute separate earnings to such items as "Refrigeration Equipment," "Heating Equipment," "Elevator," "Hot Water System," etc.

It has been tentatively suggested

that since equipment must be maintained at something approximating full serviceability throughout the life of the building and to do this it may have to be replaced outright several times; it will, therefore, become akin to an ordinary expense. Hence the income returned to the owner of the property will not, over the period as a whole include the expiration of the value contained in the equipment. If the capital investment in the equipment does not liquidate itself into the income stream but remains tied up in successive units of replaced equipment, there is no need to take account of the income derived from equipment in making a capitalization of earnings. This view seems to merit much consideration. It appears to be a revolutionary one, so has not yet undergone the fire of criticism. The logic of such an argument seems indisputable. Seemingly the only grounds left open for an attack are in the assumptions. Perhaps equipment is generally replaced and the investment maintained therein, but then again there may be cases in which this is not the case. Each problem must be decided on the facts involved.

The writer next proceeds to offer hypothetical appraisal problems. The first one is the case of a new apartment house in which it is assumed that the improvement is the highest and best use. The second problem is one in which a new apartment house is an improper improvement. In the first problem the value of the building is its cost. This is justified since it is an assumed highest and best use. The base value of the land is found by comparison. Then to this base is added the capitalization of a surplus earning that is found in a most peculiar manner.

This so called "surplus" is found as follows:

Net annual earnings before amortization and interest	\$53,480.00
Amortization of	
Building and Equipment	\$10,502.87
Interest on Building and Equipment	36,514.00 47,016.87
	<u>\$ 6,463.13</u>
8% return on land.....	2,880.00
"Surplus"	<u>\$ 3,583.13</u>

The interest on each item of building and equipment was calculated to arrive at the above item of interest deduction. The amortization item was obtained by calculating the requirements for a sinking fund at 4% which would replace each item of building and equipment within its estimated "economic" life.

An appraiser is making a fallacy when he presumes to deal with sinking funds. Yet this is a fairly common error.³ It arises because one tends to think in accounting terms. One knows that the owner of a building must deduct depreciation from his earnings before arriving at a net return on his investment. But the appraiser is not concerned with income administration. The proper task of the appraiser is to estimate the probable amount and time distribution of future incomes from a property, to estimate the probable degree of risk involved, and finally to capitalize the estimated earnings at the selected rate based on risk and going rates of interest. It is true that the estimated future incomes include a return of capital as well as earnings on capital. But that does not concern the appraiser. The appraiser must attempt a valuation of the total income stream. The owner of a property hopes and prays that the income stream will be large enough to return his investment, but it may not be of such size. Nevertheless, a buyer of such a property would be willing to pay a certain amount for the property despite its inability to reward the original investor

in full. And the price the rational buyer would pay is the present worth of the future incomes however small or large they may be. In the view of these objections it appears that the "Surplus" finally obtained in the above calculation is meaningless.

The second hypothetical appraisal problem is one in which the apartment house is not the highest and best use for the site. Hence, instead of making land residual as was intended in the first hypothesis, the building is made residual. In broad outline this sounds like a correct procedure. But the detailed calculation seems to involve serious fallacies of reasoning. Aside from the mistake of capitalizing present income, the principal fallacy again centers around the use of a sinking fund to replace the building upon the expiration of its economic life.

According to the hypothesis the gross income is \$73,110.00 and land value \$46,000.00, and the expenses of operation \$39,630.00. This would leave \$33,480 which would fall considerably short of the required earnings to take care of the charges involved in figuring interest on the investment in the building and equipment and land value, and the sinking fund on the building. This is said to indicate that the improvement is an improper one. One would readily agree were the case not confused with the sinking fund notion.

It is proposed that "The residual building value (that is, the warranted earning value) may be found by subtracting from the net income from the buildings alone, the sinking fund factor, and dividing this by the capitalization rate.

In other words, our residual building value (V) will equal earnings from buildings alone (I) minus sinking fund factor (SF x V) divided by the rate reflecting risk (R) or

³Fisher, Ernest M., *Advanced Principles of Real Estate Practice*, N. Y., 1930, p. 171.

$$V = \frac{I - (SF \times V)}{R}$$

$$\begin{aligned} RV &= I - (SF \times V) \\ RV \text{ plus } (SF \times V) &= I \\ V (R \text{ plus } SF) &= I \end{aligned}$$

$$V = \frac{I}{R \text{ plus } SF}$$

The net return from buildings alone is \$17,720.08. This figure is found by adding together the sinking fund and interest return from all items in columns G (Annual charge-off to retire investment in equipment) and K (Amount of interest on equipment) except the first item in each column, (Sinking Fund and interest on building proper), and adding to this sum 8% on the land (\$3,680.00) (and subtracting from \$33,480, net income prior to depreciation.)⁴

The actual residual building value is found thus:

$$V = \frac{\$17,720.08}{.10 \text{ plus } .01783}$$

$$V = \frac{\$17,720.08}{.11783}$$

$$V = \$150,386.70 = \text{The residual building value.}$$

To recapitulate the process:

Gross Earnings	\$73,110.00
Deduct Operating Expense	39,630.00
	<hr/>
	\$33,480.00

Deduct:-

Earnings imputable to equipment only (not building)	
a. Sinking Fund	\$5,215.92
b. Interest	6,864.00
Earnings imputable to Land—Int.	3,680.00
	<hr/>
	15,759.92

"Net income from buildings alone" \$17,720.08

This \$17,720.08 is then capitalized as indicated above by a rate reflecting both a sinking fund factor and also an interest rate. This is equivalent to de-

ducting the annual sinking fund requirement from the net earning attributed to the building and then capitalizing the remainder at the risk rate of interest. This may be proved as follows:

\$150,386.00	residual value of building
.01783	Sinking fund factor for 30 years at 4% interest
<hr/>	
\$ 2,681.38	Annual sinking fund requirement.
<hr/>	
\$ 17,720.08	Annual present earning imputed to building.
2,681.38	Deduct sinking fund requirement.
<hr/>	
\$ 15,038.70	Earnings of building above sinking fund needs.
Capitalize at 10% = \$150,386 +	

The "residual value" finally arrived at appears to have been based on the principle, if such it may be called, that the appraiser must find out how much the building is worth over and above the amount necessary to replace such an amount as it is worth, in view of the fact that there was an over-investment in the first place!

This sort of a valuation process is in reality based on a statistical illusion. It only looks logical—but in fact it is not. The \$15,038.70 is largely the result of the difference between the amount of an annuity whose present worth is the capital value sought, and the annual sinking fund requirement to replace such capital value at the end of a period. This may be demonstrated as follows:

The present value of \$1.00 per annum for 30 years at 10% = \$9.4269

⁴The clauses in brackets are my additions. The printer evidently omitted through error the last clause which has been appended to make the quoted paragraph intelligible and consistent.—Author.

The annual sinking fund requirement for 30 years at 4% to equal \$9.4269 = .01783 times 9.4269 = \$.1681+

\$1.00 (the annuity earned) minus \$.1681 (sinking fund requirement) = \$.8319, which is approximately 83% of the annuity. In other words 83% of the \$17,720.08 or \$14,707.67, would not be needed for sinking fund requirements were a sufficient sinking fund allowance deducted from the \$17,720.08 to amount in 30 years at 4% to the present worth of \$17,720.08 per year for 30 years at 10%.

But inasmuch as \$15,038.70 figure is capitalized, the sinking fund requirement is even less. That is \$15,038.70 capitalized in perpetuity at 10% is only \$150,386+ while \$17,720.08 capitalized for 30 years at 10% is \$167,045.42. Hence the \$15,038.70 figure which is capitalized to give the "residual building value" rests primarily on the difference between the

annuity itself and the sinking fund requirement to accumulate to the present worth of that annuity at the end of the annuity period.

The proper procedure in this case of an over-improvement would have been to value the land by comparison. Deduct an adequate earning on the income imputed to land and perhaps equipment. Then value the worth of the declining annuity attributed to the building.⁵

The two major errors of the procedure used in the hypothetical cases have been: the assumption that present income will continue on a level basis, no matter how hazardous, throughout the life of the property; and the deduction of a sinking fund for replacement of the building value at the end of its economic life from the annual earning before a base is selected for capitalization.

⁵Babcock, Frederick M., "Valuation of Real Estate," N. Y., 1933, Chapter 23.



Percentage of Cities Reporting an Excess, Equilibrium or Shortage of Money for Real Estate Loans

Section and Size of City	Capital Seeking Investment	Equilibrium	Loans Seeking Capital
Total for United States and Canada.....	6	4	90
New England .....	....	....	100
Middle Atlantic	8	2	90
South Atlantic	11	4	85
East North Central	2	4	94
West North Central	12	....	88
East South Central .....	....	....	100
West South Central .....	....	7	93
Mountain	8	....	92
Pacific	9	2	89
Canada .....	....	33	67
Over 500,000	10	10	80
200,000 to 500,000.....	....	....	100
100,000 to 200,000.....	4	3	93
25,000 to 100,000.....	6	3	91
Under 25,000	13	5	82
District and County Boards.....	....	....	100

—from Semi-Annual Survey, National Association of Real Estate Boards, July 23, 1933.

Financial History Of A Chicago Property

By JOHN P. HOOKER, M. A. I.

MOST of our ideas and nearly all our laws about real estate are of ancient origin. They date from the days when nearly all wealth was in the land and personal property was negligible. Populations were rural and lived on the land; wealth and real estate were synonymous. The fullest protections of the law were given to real estate. It became enmeshed in legal red tape through the desire of its owners to give themselves every possible legal protection.

In a fast-changing world we cling to the idea that real estate, good old real estate, is still the same old reliable it used to be. This may be true of country real estate but it is certainly no longer entirely true of city real estate, which has lost much of its stability and, like the world, does move. Unfortunately it also frequently imitates the song which commences, "I don't know where I'm going, but I'm on my way."

City real estate is as uncertain and changing as industrial securities. And why not? Is it not dependent on industry? While industry is agile and quick to change with changing conditions real estate still has a heavy hand. Every action is smothered in past procedure. It is the despair of laymen and the joy of lawyers, no two of whom can agree about it. A tax system a hundred years out of date oppresses it. Pick out fifty adjacent properties in any city, and if you can obtain accurate and complete information about them in six months you are a better man than I. After wrestling with it for twenty-five years I confess myself baffled but fascinated with it.

I recently examined a 25 year audit of a Chicago building in the heart of

the Central Business District. This property has been an unusually successful venture.

The figures have been plotted into a series of curves which are most interesting. The range in gross income, operating expenses, taxes, and net income is so extreme that the curves look more like the profile of a mountain range than the earnings and expenses of a supposedly stable, high grade real estate investment.

The annual rate of return, after 2% depreciation on the building, has fluctuated from under 3% to over 12%. For the year 1932 net income is at the lowest point in the 25-year period, and is still declining during the current year of 1933.

The original cost of the building was \$1,681,223. Capital expenditures have brought this figure up to \$1,860,500. The land cost \$1,000,000. I have taken an arbitrary figure of \$2,800,000, which is an approximately correct average, on which to base my figures.

Including depreciation, this property has earned just about 200% on the investment over the 25-year period, so that we can safely say that the property has paid for itself. Remember that the computations are based on 1907 cost for land and building.

One of the interesting things revealed by these figures is the rise in taxes, which are now over 300% of the average figures of the first five years.

If real estate taxes were replaced by an income tax, this income tax would have to exceed an average of 29% to

This paper was presented at a meeting of the Institute in the Stevens Hotel, June 13, 1933.

TABLE I.

Year	Gross Income	Depreciation	Operating Expense	Taxes	Total Expenses	Net Income
1908	\$301,161.52	\$33,624.46	\$120,833.84	\$40,536.39	\$194,994.69	\$106,166.83
1909	389,515.04	33,624.46	125,178.19	40,259.04	199,061.69	190,453.35
1910	398,326.37	33,624.46	146,973.08	41,686.34	222,283.88	176,042.49
1911	397,005.87	33,624.46	121,937.04	47,177.98	202,739.48	194,266.39
1912	389,424.01	33,624.46	136,756.69	41,187.11	211,568.26	177,855.75
1913	389,017.30	33,624.46	148,659.01	49,798.98	232,082.44	156,934.85
1914	391,156.09	33,624.46	150,786.78	48,207.67	232,618.91	158,537.18
1915	375,293.63	33,624.46	143,974.59	52,734.75	230,333.80	144,959.83
1916	372,022.82	33,624.46	139,755.20	52,351.86	225,731.52	146,291.30
1917	375,923.27	33,624.46	158,609.01	53,879.91	246,113.38	129,809.89
1918	387,374.66	33,624.46	206,927.76	63,523.06	304,075.28	83,299.38
1919	390,446.42	33,624.46	201,232.97	54,990.77	289,848.20	100,598.22
1920	410,802.73	33,624.46	221,623.73	66,814.08	322,062.27	88,740.46
1921	478,205.90	33,624.46	251,310.74	71,623.48	356,558.68	121,647.22
1922	529,817.60	33,624.46	236,207.42	95,892.34	365,724.22	164,093.38
1923	609,940.39	33,624.46	256,791.34	101,707.52	392,123.37	217,817.07
1924	627,125.81	33,577.17	250,085.65	102,772.35	386,435.17	240,690.64
1925	688,082.12	33,840.22	257,519.11	109,145.74	400,505.07	287,577.05
1926	734,234.15	33,843.13	248,286.87	117,569.08	399,699.08	334,535.07
1927	754,655.47	34,812.62	318,945.38	120,686.95	474,444.95	280,210.52
1928	764,021.81	36,145.92	277,024.96	135,651.47	448,822.35	315,199.46
1929	757,400.13	36,589.59	275,893.13	104,934.90	417,417.62	339,982.51
1930	728,656.33	37,110.59	268,204.80	121,078.72	426,394.11	302,262.22
1931	675,218.39	37,187.94	264,709.08	121,078.72	422,975.74	252,242.65
1932	564,503.92	37,210.01	341,441.06	141,258.52	482,699.58	81,804.34

TABLE II.

Year	Average For 5-Year Gross Income	Depreciation	Operating Expenses	Taxes	Total Expenses	Net Income
1908-12	\$375,086.56	\$33,624.46	\$130,335.77	\$42,169.37	\$206,129.60	\$168,956.96
1913-17	380,682.62	33,624.46	148,356.92	51,394.63	233,376.01	147,306.61
1918-22	439,329.46	33,624.46	223,460.52	70,568.75	327,653.73	111,675.73
1923-27	682,807.59	33,939.52	266,325.67	110,376.33	410,641.53	272,166.07
1928-32	697,960.11	36,848.81	285,454.61	124,800.46	439,661.88	258,298.23
25-Yr. Average	515,173.27	34,332.34	210,786.70	79,861.91	323,492.55	191,680.72
1932	564,503.92	37,210.07	344,441.06	141,258.52	482,699.58	81,804.34

equal the real estate taxes that have been paid on this property.

The following table shows what income tax would have to be paid to equal present real estate taxes:

1908-1912	19.9%
1913-1917	25.8%
1918-1922	38.7%
1923-1927	28.8%
1928-1932	32.5%
1932	63.3%
Average	29.4%

You will note by reference to Table I that during 1908-12 total expenses absorbed fifty-five per cent of gross income; 1913-17, 61%; 1918-22, 74%; 1923-27, 63%; 1928-32, 76%; and the twenty-five year average is 63%. For the year 1932 it went up to 89%. The net income would be the difference between that figure and 100%.

Discussion

Mr. A. C. Houghton (Washington, D. C.): Does that represent the inclusion of amortization on the building and the taxes?

Mr. Hooker: The depreciation of two per cent, operating expenses and taxes, and the balance is net income after depreciation. This is actual net income, cash money. These returns were taken off the income tax reports as filed with the United States Government. This is what the building took in in actual money and the expenses it paid,—and then the depreciation. Note that the cost of the property was \$2,800,000. I averaged this out at \$1,000,000 for the land and \$1,800,000 for the building over a twenty-five year period.

Hyde W. Perce (Chicago, Ill.): Is that per cent of expense to net income?

Mr. Hooker: This net income is the percentage of gross income. This is the

twenty-five year average—37%. In other words, including depreciation it took 63%.

Mr. Perce: How do you arrive at the 37%?

Mr. Hooker (at the blackboard): That is the twenty-five year average. The total expenses and the net income equal the gross income, and this is the way the gross income is split. Adding these two will give you one hundred per cent of your gross income. I am going to approximate them. This is gross income; this is total expenses.

Now, the net income will be the difference between these two lines, represented in here. This distance in here—these different distances fluctuate between three minus and twelve plus per cent. They run from a little under three to a trifle over twelve, and that is the range of annual net income on this property, which is a highly developed property on a valuable corner in the heart of the loop, improved to its highest and best use, a building that has been splendidly kept up, well-rented, and successful, and yet that has been the range from year to year.

Mr. E. L. Ostendorf (Cleveland O.): What type of property is this?

Mr. Hooker: It is an office building and stores, right in the heart of the loop. It is on one of the very good corners in the loop; it has been a well-maintained, well-managed building, very high-class. It has been well kept up, proper books have been kept on it, and yet, although there is plenty of money back of it so that when repairs were needed they were promptly put into the property, you have this result.

Now turn to the curve of net income. The one per cent would be \$28,000, the two per cent \$56,000, the three per cent \$84,000, and so on. At any rate, the property started in here in 1908 and the net income was just a trifle

under four per cent. It climbed up to a little over six per cent in 1909 and dipped down to a little under six per cent, and then went up to between six and seven, then dipped down to under six and fluctuated between five and six until about 1917, then took a dive down to a little over three per cent in 1918, went up a little, went down, and then about 1921 it started on a climb and, year by year, during the years of our shortage, it took a climb so that in about 1926 it got up to about twelve per cent, and then it took a dive down to ten. Then it got up to twelve again, and then it started going down until in 1932 it was at its all-time low. The average of this investment is a little under seven per cent plus depreciation, so you might say that the owner has had four per cent on a straight basis on his money, and 100% out of his building. That is 200%, and he has his property left for whatever it is worth today.

The very interesting thing about this is that in 1932, with a gross income of \$564,000, we have a net income of only \$81,000. You will notice that the taxes went up about \$20,000, the operating expenses went up about \$60,000, and the gross income fell off about \$111,000. Those are pretty big fluctuations.

Paul A. Kern (Kern & Kern, Inc., Pontiac, Mich.): Why did the operating expense go up so rapidly?

Mr. Hooker: I am unable to tell you the intimate details of these figures. I came into possession of them because I was called in on an income tax matter with the Federal Government regarding certain valuations as of 1913, and these figures were given to me. These figures are off their books for these years and had been accepted by the government. When I had a conference with the government people on the matter these were accepted as official figures. I can not answer you as to

CHART I.

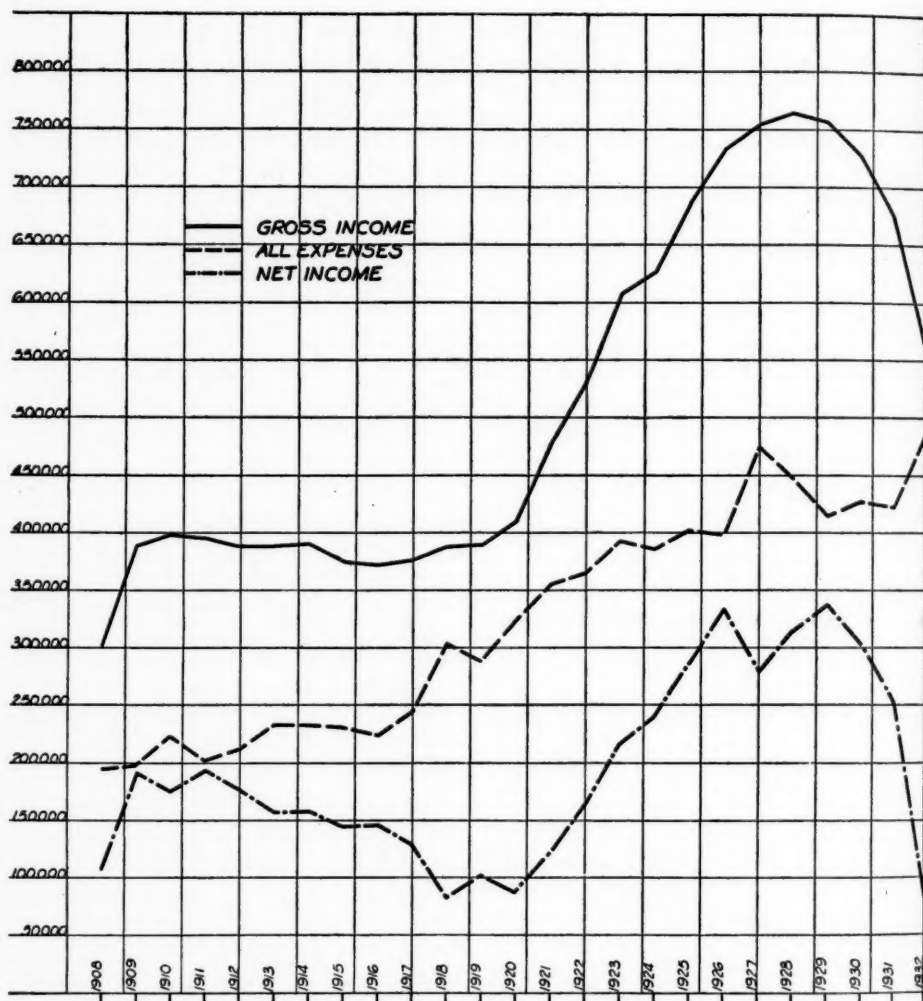
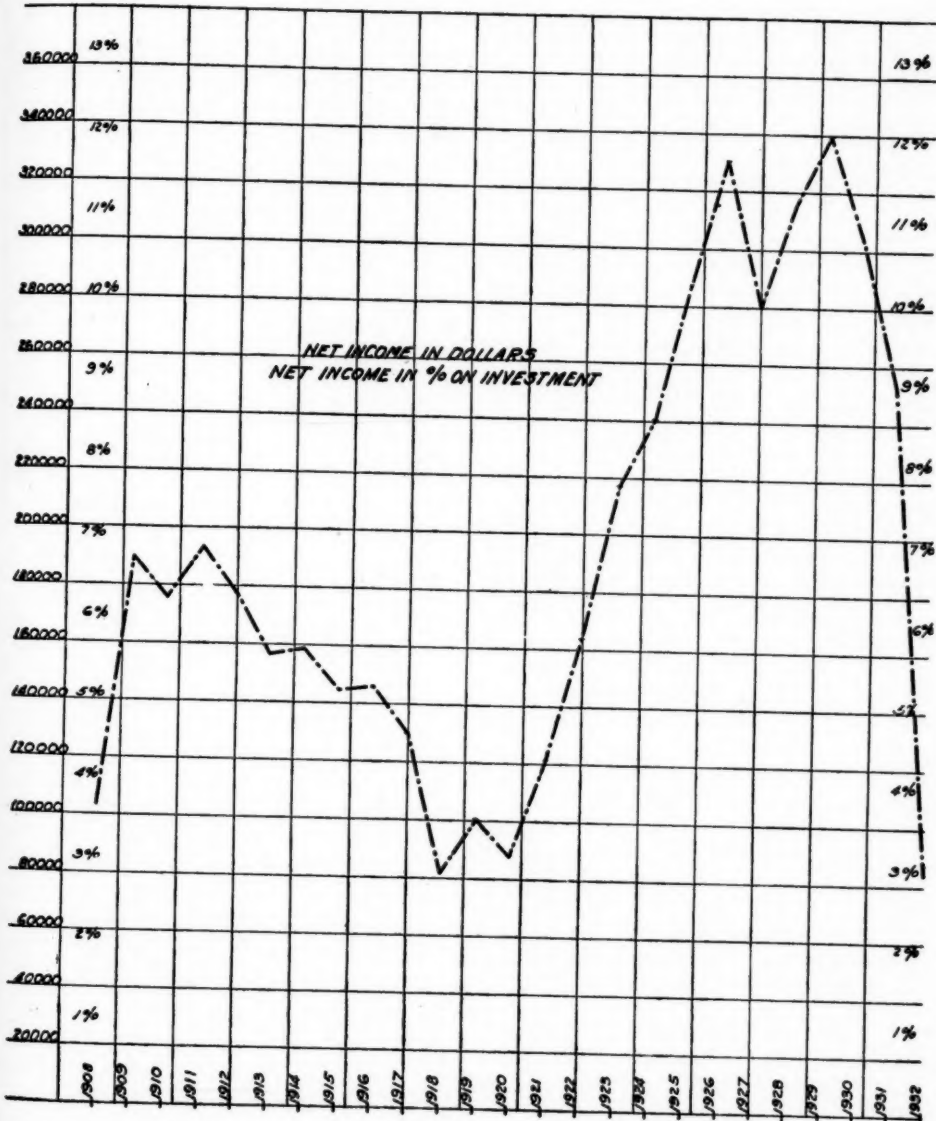


CHART II.



why the operating expenses or the gross income varied from year to year. I can only tell you that this has been a building which has always been kept up and it may very well be that from year to year certain major repairs had to be put in—possibly new boilers, changing over elevators, or any of the different things that come up.

Notice the total expenses. There is an expense of \$482,000 in 1932, and back in 1927, there was an expense of \$474,000.

The interesting thing about this chart over this twenty-five year period is the way gross income and expenses and net income jump all over the map. If you will go to your five-year averages, which are shown below the twenty-five year average, you will notice the same fluctuations there. For instance, if you will turn to the last column on net income on your five-year average you will notice that, in the first five years, 1908 to 1912, the building produced an average rent of \$168,956.96. For the next five-year period it declined to \$147,000 and then, from 1918 to 1922 it went down further, to \$111,000. Then, in the next five-year period, it took this terrific jump and went up to \$272,000. The period from 1923 to 1927 was the all-time high during this twenty-five year period and then, for the period 1928 to 1932, it declined to \$258,000 and last year it went down to \$81,000. That is also brought forth if you consult the chart of net earnings over here. You can see how it went up from 1917-18 and then took its nose-dive again.

The interesting thing about all these figures to me has been the difficulty of making predictions in advance. If we take a capitalization of the net income figured on any basis you want—this is a building in the heart of the loop, fully improved—let's take it at seven per cent for the purpose of argument

—that certainly would be a good return on downtown property; seven per cent depreciation. I don't think we could say that that was too low in the heart of the loop.

Now we will take 1908 to 1912. You get a valuation of \$2,413,671. For 1913 to 1917 you get a net income of \$147,306.61 and a valuation of \$1,104,380; 1918 to 1923, \$1,600,000; 1923 to 1927, \$3,800,000; 1928 to 1932, \$3,700,000. If you want to take the year 1932, you get \$1,170,000, and if you want to take the five-year average it is \$1,960,000 plus depreciation, as compared with this figure for the twenty-five year average of \$2,738,000. It is a pure coincidence that these figures happen to check out so close to that rate.

Mr. Houghton: May I ask whether that valuation set-up is expected to cover the land value or the increment in it?

Mr. Hooker: This property is on a 1907 cost. This takes into account no appreciation in the value of the land since 1907. It does not take into account any appreciation there may be in the reproduction cost of the building. As a matter of fact, this building has done a great deal better—it has been one of the very good earners among the buildings in the Chicago loop district. The average building has not commenced to do as well as this building, and the showing which this building has made is far superior to the showing of most buildings.

Mr. E. A. Undeland (E. A. Undeland Co., Omaha, Neb.): Your 1932 figures are off. Your net income should be about forty-some-odd thousand instead of \$81,000 according to your figures.

Mr. Hooker: May I ask how you get that? Did the total expenses include depreciation?

Mr. Undeland: It is included in there.

Mr. Hooker: You add \$37,000 and \$341 and your taxes and you get—

Mr. Undeland: You get over \$500,000—\$582,000 instead of \$482,000.

Mr. Hooker: It is possible that I have made an error. I know the \$81,000 is correct. I had to make about 1,000 or 1,500 computations there. I thought I cross-checked them all. At any rate, the \$81,000 is correct. I tried very hard to check all these figures, but I am not an accountant and I am glad you called my attention to it, because I can state that the \$81,000 is correct.

Mr. C. E. Reeves (Buffalo, N. Y.): It occurs to me that inasmuch as you have charged depreciation currently annually at the two per cent figure for the twenty-five years that then has retired, in so far as the building is concerned, about fifty per cent of the capital investment, so that then your \$81,000 net for 1932 represents approximately four and one-half per cent on the actual dollar investment.

Mr. Hooker: I have stated all along that this is that per cent plus depreciation.

Mr. Reeves: So that your percentages of 3.9 up to twelve represent a net return on the original investment and disregard the fact that a large part of that original investment has been returned to them through the depreciation charge.

Mr. Hooker: If you want to figure it another way 'round you can figure that over the twenty-five year period the property has earned an average of eight per cent net before depreciation. It comes out just a fraction over 200% if you want to take it on that basis. This property has earned eight per

cent before depreciation, or a little under seven after depreciation.

Mr. V. M. Covington (Covington Co., Jacksonville, Fla.): As a result of these figures and of what we heard this morning, under our definition of a property and all, doesn't this seem to indicate that we are undertaking something rather serious in profits when we try to project and carry out the value of a property too far in the future? I would like to hear some discussion on that, because I think we are going to have to change one of the fundamental precepts of our appraising. We are projecting too far into the future.

Mr. Hooker: I said in my opening remarks that I think we have, to some extent, to revise our ideas about city real estate. It rises and falls; it is no longer as stable as we used to consider it. The chart of earnings of this property is an indication of that. Your off-hand concept of buying a piece of property is that over a term of years you want to enjoy stable earnings. In other words, when the average man goes to buy an operative property his notion of it is that his earnings will be reasonably straight. The curve may waver a little like this, but as a matter of fact, this doggone thing goes all over the lot!

There wasn't a five year period during this twenty-five year period in which a man relying on the average expenses or taxes of the previous five year period could base an accurate estimate. None of his predictions on the preceding five years would come true if he carried them out for another five year period.

Mr. Houghton: I notice that you have carried your costs of 1907, which were at an entirely different cost value level, with those of 1927. Your income has taken on the increase brought about by increased costs at that period, and by demand. There is

an unusual condition there as a result of the war. If that part were wiped out, we would regain some sort of average, it would seem to me.

Mr. Hooker: That ten year period is what sold the investment out and produced this average. This is when all the value came in, right here. For the first fifteen years of the investment, as a matter of fact, it slowly slid down hill. Then it took this marvelous jump and then it started sliding down again.

Mr. Slonim: May I ask why the depreciation factor is a constant for fifteen years, and then you suddenly make it a variable factor?

Mr. Hooker: Again I can only say that I went by the record which was given me. I cannot go back of the figures. They are official figures off the books of the property, accepted by the government. Why the operating expenses jumped around for different years I do not know.

I want you to turn to Chart III and look at the taxes. You will notice that over a twenty-five year period the taxes have risen from a trifle over \$40,000 up to over \$140,000. The 1932 taxes were 350% of the 1908 taxes.

The average taxes, if you go back to your five year averages, are \$79,861.00, just about twice the amount they were to start with, that is, the average for the period is about twice what they were to start with. Of course, you will notice that during the fifteen year period while the income went down, the taxes went up. We are over-taxed.

Suppose we did not have any real estate tax. Suppose we had an income tax on property. Just imagine what a terrible squawk would come up if a 30% income tax on real estate were imposed! Yet, that is what we are bearing. Last year, for the year 1931,

in Chicago I believe that a lot of properties were paying more than 63% of their income after operating expenses, in taxes.

If we ever get, in this and other cities, the rule that taxes should be limited to 1% of the fair value of a property, then we shall probably see real estate on the road to recovery. I don't think prosperity is ever going to come back while we have to pay the taxes we are now paying.

For some time, I have been advocating audits of property. There isn't one property owner in a hundred who keeps his books right. How many gentlemen in the audience have seen a ten year audit of property? (9); How many have seen a fifteen year audit? (5); How many have seen a twenty year audit before this morning, when Mr. Levy brought his figures in? (2); How many have seen a twenty-five year audit? (1).

Here is an audience of appraisers. Nine have seen a ten year audit, five a fifteen year audit, two a twenty year audit, and one a twenty-five year audit. I will be perfectly frank. I have been in the real estate business in Chicago for almost twenty-five years and I have been able to get two long term audits, and that is all. I know it is very difficult to get them. If more properties were properly audited I think all of us would know a whole lot more about real estate than we do.

Take these figures home and study them. Monkey around with them a little. Make some figures; you will find them rather interesting.

Chairman Hall: It seems to me that the type of information which we received this morning on detailed operation of a building over a period of years, is just the type of information which we need to a greater extent. It is not possible to make accurate pre-

dictions. I am not the seventh son of a seventh son, and neither, I judge, are any of the rest of you, but when we are buying a piece of property, if it is an income property, we are interested in the income the property will produce because that is what we hope to get out of the property. So it is necessary for us to take the future income

into consideration in arriving at our values.

The more information of this nature we can secure to find out the actual experiences of buildings, the operating income and expenses, the better position we will be in to estimate so far as possible the future life and future income of the property.



The Modern Appraisal Kit

The writer recently created for his own Appraisal Department an Appraisal Kit. It consists of a large black grained leather brief case, in which have been made a number of compartments, accommodating many articles which have been found to be not alone useful and convenient, but frequently very necessary. The case may be kept locked to insure the presence of its contents when required by the appraiser or operator. The Appraisal Kit contains the following: A camera with sharp, fast lens, as many photographs are taken, not alone of the appraised property but of the surrounding neighborhood including other properties or conditions that may have an effect on a final conclusion, adversely or otherwise. Then there is a magnetic compass enclosed in a silver watch case, which is most helpful in field work, where no other means of identifying points of compass are at hand. Another item is a traffic counter made to fit the palm of the hand and about the size of a large walnut. This counter has four sets of figures and is used in counting automobiles and pedestrian traffic. Then there is a teleheight, an instrument used to determine heights of buildings, a necessary factor in calculating their cubical content; and a planimeter (used in conjunction with the teleheight), a device used to determine from plans the square foot area of buildings or land. A steel tape and a steel rule which can

be used as a flexible tape or a straight 9-foot rule making it possible to reach up on the outside of buildings, or to measure ceiling heights in the interior of buildings without the use of box or step-ladder. An electric flash light,—used to pilot the appraiser through dark places. A set of drawing instruments and small wooden drawing board, on reverse side of which is locked a "T" square and two triangles; a box of colored crayon; two metal ink bottles,—one containing red and the other black ink, a box of postage stamps and envelopes enabling field men to mail back to the Home Office, films, maps, and plans. The latter can be photostated, enlarged, or reduced and made ready for the appraiser's return, to make the final dictation. Another box contains rubber bands, erasers, etc., and a file containing a complete assortment of appraisal stationery. Recently, an "altimeter" has been added to the kit. The instrument is fastened around the waist of the field man and used to record topographical elevations on right-of-way appraisals or those involving large land areas. This complete Appraisal Kit, including the specially made leather case, but not including the "altimeter" cost the writer about \$180, while the "altimeter" cost \$150. The kit has proved of great importance on many an appraisal assignment.—From "Real Estate Appraising," by James D. Henderson, M.A.I.

New Problems For The Appraiser

By STANLEY L. McMICHAEL, M. A. I.

THERE was a time in the not long distant past when an appraiser, with utmost confidence, would willingly accept almost any kind of an assignment, proceed to make his investigation carefully, then formulate with reasonable accuracy and certainty a report of his findings. And, in most cases, provided he knew the fundamentals of his profession and was thoroughly honest, he was correct, within a reasonable margin, in the value finally arrived at.

Today the conscientious and competent appraiser accepts employment with reservations, confident that he can render a well-considered and warranted opinion but demanding that he be given fully all of the facts and information he requires and asking sufficient time to complete his study and transcribe his impressions and opinions into a definite report. He is not so sure, any more, that he knows *everything* there is to know about appraising!

The wail goes up on many sides: "There is no basis on which you can fix values". In the existing distressed condition of the real estate market during the present spring of 1933, it is sometimes difficult to fix definite values, supported by convincing evidence sufficient readily to substantiate them. With an entire absence of sales records for several years, rental schedules blasted far below their reasonable level due to erratic economic conditions, many tenants failing or absolutely declining to pay rent, an almost entire lack of confidence or demand on the part of the investing public, with speculators mere memories of the dim and distant past, it is sometimes puzzling for the present day appraiser to

marshal facts and figures on which to support predicated values. In the meantime physical depreciation forges ahead rapidly due to the disinclination or inability of property owners to spend money for repairs or even ordinary maintenance. Obsolescence, that grim monster that thrives on depressed economic conditions, stalks abroad, silently but ruthlessly blasting its way through the weeks, the months, and the years.

During the earlier part of the past decade, the flush times of real estate expansion, *every* real estate man considered himself an *expert* appraiser. All he did in most cases, was cheerfully to confirm an owner's opinion of value and express sublime confidence that the property would increase substantially in value. The strange part about it was that he was very frequently right. America was enjoying a steadily advancing price market. Real estate, bought almost anywhere, at anything like a then considered reasonable price, was almost certain to increase in price, if not in value, within a reasonable period. Truly, those were the days when appraisal "experts" flourished throughout the land.

Those were the days too, when the banks, the savings and loan and the mortgage companies thought it was wise to hire their so-called "appraisers" at office boy compensation. One of these valuating marvels would hop into his Ford car, visit twenty or thirty properties a day, jot down an estimate of value as he stopped at each one for a moment enroute and turn in his report at the end of a hard day's work (hard for the car!). Subsequently there rolled out from the banks, the loan associations, and the mortgage

companies vast volumes of mortgage funds, chief consideration being given, not to actual or even reported appraisal values, but to the fancy bonus the institution in each case was receiving for making the loan. Now, unhappily, the banks, loan associations, and the mortgage companies possess much of the property on which they loaned, or may before they set their houses in order once more.

Even today a lot of these institutions do not know what values actually are, or how to arrive at them. Some executives in charge are beginning dimly to comprehend that an entirely new deal is in store for their appraisal departments before a general resumption of loaning on real estate can be proceeded with.

Out of the chaos into which real estate has been flung by irresistible economic forces in these recent times will come new standards and new practices. These, fundamentally, will be based on sound determination of value and only thoroughly qualified and certified appraisers should be accepted as being worthy of furnishing opinions. To those already qualified or anxious to become so, I address a few observations on some of the factors which will enter largely into future determination of value of real property.

At the outset, it becomes necessary to revise old codes of appraising practice and adopt practices which can be justified under new and changed conditions. The old plan of making merely skillful guesses at value must be replaced by methods which call for actual proof. Residential properties will continue to be valued on a basis of replacement costs, taking into consideration various pertinent factors relating thereto. Investment properties may be weighed and valued on a basis of their income productivity coupled with the present worth of their future

benefits. While acceptable methods for attaining this end have not as yet been fully evolved and may be subject to varying changes from time to time, nevertheless enough is already known to standardize the practice to a degree that makes the valuation of income properties a comparatively simple matter.

The appraiser's greatest need, at the moment, is more knowledge dealing with the perplexing problems involved. Valuers particularly require a wider knowledge of the economic background on which this country was built and on which real estate solidly rests today, than ever before.

What are some of the fundamental factors which appraisers must keep in mind in approaching the valuation problem from this time on into the future? Some of these have been coming into existence during the past several years while others seem to be just appearing upon the horizon. All of them, however, are likely vitally to affect results in individual appraisal problems.

Population

Consider, at the outset, the problem of population increases. Appraisers have long considered it axiomatic that increase of population in a given area has a direct relation to increases in neighborhood property values. A static or slow growing community feels little stimulation for real estate expansion. Sales are few and the element of speculation is entirely absent from the picture. Areas which are expanding rapidly in population feel the quickening impulse of investment buying and speculation. Sales are frequent, building is active, speculators buy and sell in the hope of making speedy profits and not only prices but values, as represented by rentals, respond to these stimulating factors.

What do we, as appraisers, find concerning this subject of population? We recognize that with the cutting of immigration quotas, about as many persons are leaving American shores every year as are coming here. The death rate approximates about one half of the birth rate, if I remember rightly. Statisticians tell us that by 1950—and 1960 or 1970 at the very latest—the United States as a whole will probably cease growing in population, that it will then remain practically static, as Europe has remained static for decades. That certainly means that every city will have enough subdivision lots and to spare, that there will be an abundance of parcels available for business and multiple dwelling purposes and that speculation in vacant land will have come to an end. In the face of such a condition fifteen to thirty years hence, what are the values of thousands upon thousands of present day vacant lots, suitable for a large variety of purposes which have been and are being subdivided upon the borders of hundreds of cities throughout America?

Shall we ignore this approaching condition or shall we decide to discount more or less, all speculative values against the day when their utter exhaustion takes place?

To what extent should every appraiser consider the vital subject of decentralization in appraising property in, and adjacent to, the larger cities? Most students of real estate agree that very few American cities are now growing in population. The depression too, has shuffled the population around. The trend towards city life ended about 1925 or 1926 and has slowly reversed itself to the wide open spaces.

Business Districts

Down town sections of most of the larger cities are absolutely static, if

not suffering retrogression at the present time. The automobile has throttled business activities in many of them and shoppers are loath to go down to central business districts except on extraordinary bargain hunting sprees. Huge department stores vie with each other in promoting price cutting sales at which goods are almost given away. This is steadily killing off minor competitors of these stores in the downtown areas. Vacancy units increase and where many small merchants are still doing business they are suffering losses and failing to remit rents to their landlords. Whether this condition will right itself when buying power is restored by better economic conditions remains to be seen. In the meantime new outlying business sections are soaking up much of this diverted buying power, lowered in volume and capacity, it is true, but valuable nevertheless. The housewife is learning in many instances that she can shop as economically in the outlying areas as downtown and at far less physical discomfort. With rental productivity visibly lowered in downtown areas, how shall the appraiser approach the duty of establishing the present worth of future benefits in a downtown district subject to such a questionable future? Can it be done by involved mathematical processes or otherwise? It seems to me that only the calm, seasoned judgments of appraisers, with studious backgrounds of experience and accomplishment, can finally be relied upon to answer these problems. It means that competent appraisers must acquire and intelligently use more factual data in solving future problems and in eliminating the degree of error involved in making most appraisals.

Appraisers must keep definitely in mind the changing economic conditions to which downtown property of all kinds is being subjected. Depreciation and obsolescence of buildings of

all kinds is steadily progressing. Diminishing business profits of tenants is curbing and extinguishing rent paying abilities. Landlords consequently are not maintaining their properties as they should. Vacancies in large numbers are occurring; and, when re-rental takes place often a lower and possibly an objectionable type of business intrudes. A downtown central business area, always surrounded by a non-descript collection of formerly high grade homes which have degenerated into boarding houses of all kinds and types, now often translated into blighted areas, is naturally hemmed in with this low grade buying power, and must depend for more profitable trade on higher grade residential districts farther out, whose occupants for the most part, visit the downtown area by automobile. This is frequently so difficult and uncomfortable that it is found that this favorable class of buying power is, to an increasing degree, deserting the downtown areas and doing business at strategic outlying business centers which are steadily attracting and capitalizing this buying power into higher land values at such locations. Just at the moment, and in the absence of any decided impulse for a renewal of downtown business activity on a large scale, the outlook for central business district values is uncertain and vague.

A re-alignment of business property values, particularly, is likely to follow the steadily advancing tendency for suburban growth due to the continued use of the automobile but particularly due to the appearance of the five day work week, now so generally in vogue in many of the larger cities. Do not wait longer for the coming of the five day work week—it is actually here, to the extent of probably 25% of the gainfully employed persons in cities. That it will be extended in the future, to me seems certain. Apart from

economic effects of this change, consider its affect on land values. It means a further acceleration of the tendency to decentralize trade. Business centers will be more far-flung than ever. Thousands of "small farm" homes, from one half to two acres in size, probably will crop up in the suburban districts of cities during the next decade. Strategic cross roads of commerce, now improved with a couple of gas stations may become town sites of importance a decade hence, surrounded by relatively populous districts of residents who will be able and willing to trade in their own home neighborhoods. The appraiser must indeed have a discerning mind and an appreciative and critical eye when called upon to appraise suburban acreage which today may be almost vacant and which five years hence, may become the throbbing heart of a newborn business community.

Valuation of Buildings

Equally perplexing are some of the problems which appraisers face in connection with the valuation of buildings. Depreciation and obsolescence progress steadily regardless of time or place. New building materials and devices and methods of construction are daily being created, cheapening and improving old practices and lowering the factors of reproduction cost to standards where values in existing structures are in some cases diminishing rapidly, while an uncomprehending public looks on complacently.

It is true that building costs are remarkably cheap at the moment and yet one can conceive that a building erected today may be worth more money several years hence, regardless of the offset for depreciation and possible obsolescence, by reason of advancing price levels of building commodities and labor. The blight of existing low prices, however, attaches

itself to old types of buildings which are rapidly outwearing their usefulness and which must, in the course of a short time be replaced if economic rent is to be obtained from them. This return of income will depend, in large measure, upon resumption of business and industry, and the demands they will make for new structures, and the adaptation of old buildings to new and more modern uses. Obsolescence has probably never been reaping as heavy a toll on building in American cities as at the present time.

An impending housing shortage in America promises a revolution in home building practices. Probably no type of construction is quite as wasteful and slow as that of building houses. While the material mass involved is less, the building of a motor car is a much more involved process than constructing a home, yet motor cars are turned out in mass production at tremendous speed and amazingly low prices. It is reasonable to suppose that a strong demand for houses will bring forward new, novel, and inexpensive methods for building them, lowering the price level per unit, and bringing down to new low levels the depreciated values of existing structures which remain in competition with the new offerings. These facts must be kept in mind by the appraiser in valuing existing residential buildings. Processes for establishing the present worth of future benefits of buildings may remain the same mathematically but they are going to be subject to vast variations as far as invention of materials and construction methods may have their way.

Governmental Activities

Governmental activities both at home and abroad as translated into prices of money, the interference of trade through the raising of tariff barriers and similar factors, will doubt-

less have important effects on the value of real estate in this country. What President Roosevelt and the Congress does or does not do in the next few months will doubtless affect real estate vitally. We, as appraisers, must watch progress of all governmental activities for they vitally affect our judgments of value as they become translated into economic gains or losses.

Governmental action, National, State, and Local, in regard to taxes must be watched carefully; for we must realize that every dollar in taxes saved on real estate, translates that dollar into a larger return imputable to land. As maintenance costs are lowered, this means that rentals received can be converted into profits for the owners of land.

Recent inflationary actions by the United States government in regard to issuance of new currency will doubtless result in higher commodity prices. Real estate is certain to advance with the rest of them. This will stiffen rentals; and higher price levels for real estate will eventually result. These are matters which appraisers must carefully study. Be a constant student of economic matters; for appraising, in the final analysis, is one of the most difficult and exacting procedures that any man can be called upon today to do, and it is linked directly to many economic factors.

There is no one who should know more about the reasons for booms and depressions and the psychology of the conditions surrounding each, than the expert real estate appraiser. Opinions of value are given by appraisers as of given dates and may reasonably vary from time to time, due to new conditions which may appear in the economic life of the community and nation. Do you know what causes a boom? Why booms are ultimately followed by depressions and panics? If not, get busy and find out the reasons

for both. It will temper judgment and season your opinions regarding many phases of real estate activities and values.

A principle appraisers must keep in mind more and more, is based on the observation made by Frederick M. Babcock when he declared that an appraisal must be predicated upon a stated program of utilization. This determines the highest and best use to which a property can be put and then weighs the possibilities of obtaining an income based on that assumption. Some properties can be easily adapted to their highest use while others are encumbered with improvements or lease conditions which prevent such use.

It seems to me that one of the greatest tasks appraisers face is the accumulating of factual data of a reliable and understandable character to be used as the basis for determining war-

ranted values in many classes of property. Some research has been conducted into the problems of costs of operating office, commercial, and apartment buildings; but it has been fragmentary and subject to change in different sections of the country. Through concerted action taken finally by the American Institute of Real Estate Appraisers, a comprehensive program providing for the accumulation of factual data which shall be kept up to date through regular additions and revisions, shall a firm foundation finally be created for an appraisal technique which shall be uniformly helpful in all parts of this vast country. Such a program must be evolved in our American Institute of Real Estate Appraisers and the duty of making contributions assigned to member appraisers in all parts of the country, the data finally being woven into a compact and usable plan, by a committee representing our national body.



Percentage of Cities Reporting Rising, Steady or Falling Interest Rates on Mortgage Money

Section and Size of City	Rising	Steady	Falling
Total for United States and Canada.....	24	65	11
New England	8	59	33
Middle Atlantic	20	65	13
South Atlantic	13	74	13
East North Central	35	56	9
West North Central	22	78	....
East South Central .....	....	100	....
West South Central	29	64	7
Mountain	36	64	....
Pacific	24	61	15
Canada .....	....	100	....
Over 500,000	37	50	13
200,000 to 500,000.....	37	63	....
100,000 to 200,000.....	18	67	15
25,000 to 100,000.....	29	65	6
Under 25,000	16	72	12
District and County Boards.....	14	61	25

—from Semi-Annual Survey, National Association of Real Estate Boards, July 23, 1933.

Comment And Discussion

De Mara — On Forecasting Income

IN my opinion it is particularly difficult at the present time, in view of the rapidly changing economic conditions, to forecast the income from a property, the rental of which is based on a percentage of sales. For the past two years with falling commodity prices it was very desirable for tenants to secure percentage leases; during the past month with commodity prices rising and with inflation becoming a fact instead of a possibility, the owners in my experience are more agreeable to percentage leases and the tenants more reluctant to make them.

As the income from a property under a percentage lease is a direct ratio of the volume of business done expressed in dollars, the first part of the problem resolves itself into forecasting the volume of business that a merchant will do in the location; the second part of the problem then is to forecast the trend of commodity prices, or in other words the future value or purchasing power of the dollar or unit of currency. It is significant that in the past two years many leading Chains have shown an increased volume expressed in amount of merchandise sold, but with a drastic decline expressed in terms of dollars. Of course the dollar sales from week to week or month to month indicate definitely the present earning value of the property, but in order to arrive at a fair estimation of the freehold it is certainly necessary to make an estimate of the future earnings.

In my opinion the first step is to secure a statement from the tenant of the amount of business done over a period of at least the three previous years in as nearly a comparable location as possible. This would form the

basis for estimating the volume of business that the tenant will do.

The second step and one that is not encountered in a straight lease, is to make a forecast of the probable trend of commodity prices. This would materially increase or decrease the dollar volume of business, and is something that is entirely beyond the control of the tenant.

Then, of course, the usual estimate would have to be made as to the probability of the general growth of purchasing power in the district, and as to the future of the particular city or district in the city. These, however, are conditions that are not new and would apply to percentage leases in the same way they would apply to any other type of lease. Once the valuator has arrived at his opinion of the probable income in dollars over the period of the lease, the method of applying this to capital value would not vary from the usual methods employed in connection with other types of leases.

Cyril R. De Mara, M.A.I.

Hamilton, Ontario, June, 1933.

Musch — On Professional Ethics

IT is my idea that any society of a professional character should in no way be used for advertising with a view to benefiting one's business. A mention that one is a member of such a body is permissible, because it simply establishes one's connection with it. And even this mention should be conservatively done and with as little fuss as possible. The "bally-hoo" that some of the members have been doing, to my mind, removes them from the Institute as far as their professional standing as appraisers is concerned. It

cheapens not only them, but the Institute as well. They're in it for what they can get out of it! A connection with a professional organization is made by professional men with a view of benefiting the organization through member affiliation.

I can readily understand why this seeming thoughtlessness in promiscuously plastering the public with M. A. I., the seal of the Institute, the reproduced Certificate, its pin, and what have you. The Institute is made up of men of mixed interests. Fundamentally, a goodly percentage of them are successful real estate salesmen. Their enthusiasm made them successful. Through the commercialization of their ability, they have become prominent in the real estate field. There is no criticism. But to reconcile the factors that make exceptional salesmen with those factors which are fundamental to good real estate appraising is, in most instances, psychologically doubtful. The high appraisals of 1928-29 demonstrate this.

We can hold no one at fault because the opinions were, no doubt, honestly arrived at through what information was considered essential. And, too, we cannot overlook the fact that the personalities clash—the appraiser must be a thinker, the salesman must be an enthusiast. The appraiser sells over a span of years, and the salesman sells in the present market.

So, naturally, the salesman treats the Institute as he does his other commodity—does everything possible to bring his connection with it before the public at once. Real estate can be handled in that manner, but not the *appraising* of real estate. The one is material, the other—thought.

The first thing to do is to divorce, in our own minds, the one from the other. Let us not, in our printed matter, refer

to the Institute other than by the use of a printed line establishing our connection with it. The seal of the Institute has no more place on our forms and stationery than does the college seal have its place on the prescription of the graduate physician, or on the brief of the lawyer.

The M. A. I. designation, I am reluctant to use because of its similarity to, and therefore its suggestiveness of a college degree. It seems to me a bit misleading. I will prefer a single line as mentioned above, which leaves nothing in doubt and serves the same purpose. To use both would not only result in duplicity but confusion to the reader as well. I think, also, that the appraisal itself reflects the thought and ability behind the opinion involved, and that M. A. I. after a signature will not make up for any of its short-comings.

The Institute cannot flourish as a professional body without expressed dignity in our printed matter, and the simpler the rules governing the restrictions, the better it will be for all of us. The commercial aspect must be entirely removed.

To make the Institute a valuable organization of itself, membership should be contingent upon the yearly contribution of a piece of research designated by the proper committee and assigned by it to groups of members, the findings of each individual of the respective groups to be compiled by that committee and returned to the members at large. I think this latter suggestion most valuable in quickly establishing the professional standing of any organization. Such a methodical effort would do much to reconcile opinion and would soon tend to simplify much that is now confusion. And

it would stamp our members as *real* appraisers.

Henry Musch, Jr.

New Haven, Connecticut.
February 24, 1933.

Layden — On Professional Ethics

FROM the beginning, the Institute membership has been limited exclusively to individuals. It is a professional organization wherein the members must have certain requisites impossible for anybody but an individual to have. "A corporation is an artificial person created by law for purposes which natural persons would be unable to accomplish. As a legal person it is invisible, intangible, and immortal." No such person could appear as an expert witness in a condemnation suit—no such person could join the Institute, and no such person is entitled to either the use of the emblem or the initials M. A. I.

In partnerships, the individual partners must become members of the Institute and the only instance where a partnership would be entitled to use the emblem would be where *all partners* were individual members of the Institute. Often an engineer and an architect will form a partnership to better handle such business as they may get, but in this and many other states they are not allowed to use the designated "architect" and "engineer" unless *each member* is both an architect and an engineer. Their stationery, advertising, et cetera, cannot generally state "Members of the American Institute of Mechanical Engineers", or "Members of the Architects Institute" unless all members so belong. Their affiliations must be designated individually.

A degree from a university to an individual does not allow all members

of any firm with which he may be connected, or the firm itself, to use the title such as A.B., L.L.D., et cetera. In my opinion this same condition should obtain in the American Institute of Real Estate Appraisers.

I am a member of a firm of Realtors, but no other members of the firm, nor the firm itself, in any way use the emblem or the initials M. A. I. on their advertising, stationery, et cetera.

On the other hand, the Institute is young and, as yet, relatively unknown and any advertising that it can get will, I believe, be to its advantage and the advantage of all the members. I also believe that the members are entitled to the use of the emblem or the initials M. A. I. *if they are used in such a way that there can be no mistake as to just who the member is.*

To solve this situation in my case, no advertising, stationery, et cetera, of our firm will carry any reference to the Institute, but I will have my own private stationery carrying the emblem for use in connection with anything having to do with the appraisals or appraisal work of my own.

A. L. Layden, M. A. I.

Los Angeles, California.
April 4, 1933.

Ferguson — On Professional Ethics

ARTICLE VI, Section I of our Rules of Professional Ethics states: "It is unethical for an appraiser to issue an appraisal report for a fractional part of a property, unless he specifically states that the value reported is invalidated if used in making a summation appraisal of the property as a whole."

Question 1

Does this regulation apply to the valuation of properties such as those

owned by a gas company when that company is a going concern and the purpose of the valuation is for consideration by a Public Utilities Commission for the determination of rate making, the valuation to be given in testimony before the Public Utilities Commission and subject to cross examination?

Question 2

Should a real estate appraiser refuse to value ground alone owned by such Public Utility Company if he were not expecting to give testimony and without the above invalidated clause?

Answer 1

It would seem perfectly proper for an appraiser to value the land alone for rate making purposes. In direct or cross examination he would have ample and full opportunity to state, and should so state that his appraisal would be invalidated if used for any other purpose. Again, the principal object of the Standards of Practice and the Code of Ethics is to obtain as precise as possible a true value of any property under consideration.

The ideal value generally might be said to be where the improvements occupy the highest use. Certainly this is true in the case of the average property used by a Public Utility and would be entitled to a value consistent with its reproduction cost less physical depreciation. It would therefore seem that no improper use or injury would accrue in the appraisal of the land only under these circumstances.

Answer 2

It would clearly be in violation of Article VI as written if an appraiser appraised the ground alone. The fact that it was a Public Utility would not enter into the matter at all. The oppor-

tunity to misuse the appraisal would be the same as in any other fractional appraisal.

W. E. Ferguson, M. A. I.

Baltimore, Maryland.

February 17, 1933.

Ostendorf — On Professional Ethics

Answer to Question 1

THE Standards of Practice specifically state that they "deal with appraisals of properties exclusive of agricultural, industrial, Public Utility, mineral and forest properties." I, personally, do not feel that it is possible for a real estate appraiser to give a fair appraisal as to market value of Public Utility property in use unless special study be given to that subject.

Answer to Question 2

A real estate appraiser should not refuse to value ground only, owned by such a Public Utility, if he is not expecting to give testimony and without the invalidating clause.

When a Public Utility is in a substantial operating condition, it is my opinion that the only fair method for appraising is by the summation procedure.

E. S. Ostendorf, M. A. I.

Cleveland, Ohio.

March 17, 1933.

Shattuck — On Professional Ethics

Answer to Question 1

IN my opinion the regulation should not apply. There should however be a condition contained in the Appraisal Report stating that the sole purpose of the appraisal is for the determination of rates to be charged the public.

Answer to Question 2

In my opinion a real estate appraiser should not refuse to value the land alone, owned by such a Public Utility. There should however be a condition in the Appraisal Report stating that the sole purpose of the appraisal is for the determination of rates to be charged the public.

Chas. B. Shattuck, M. A. I.

Los Angeles, California.
March 10, 1933.

McMichael — On Professional Ethics**Answer to Question 1**

NO, the regulation should not apply in such a case as indicated. Under practically all state laws, gas companies have the right to fix their rates on the basis of a reasonable return on their investments, carrying charges, etc. Properties of public utilities are alike, in many ways, with service properties used by governmental units and the replacement appraisal method may be used for their valuation. The appraiser should have the right to use the replacement method in the above valuation and make a fractional appraisal if he so desires.

An exception to the above should be definitely noted if the gas company proposes to sell an income property which it is not using and a buyer proposes to acquire it as an investment. For instance, if a value was being determined for rate making purposes alone, a reproduction cost of land and an office building thereon might be properly offered. However, assume the case of a merger of two gas companies and an appraiser is called in to set up a valuation on an office building which would not be needed and was to be sold to some one on an investment basis. An appraiser in such a case would be justified in insisting that he

treat such a building as an investment and appraise it on its income bearing possibilities, as a complete investment unit.

Answer to Question 2

Should a real estate appraiser refuse to value ground alone owned by such a public utility if he were not expecting to give testimony and without the above invalidating clause? The appraiser would be fully justified in this case in valuing the land by itself and should not be required to insert an invalidating clause, on the assumption that the valuation would not be used only for rate making purposes.

Stanley L. McMichael, M. A. I.

Hollywood, California.
February 26, 1933.

Hall — On Professional Ethics

IT is my opinion that the regulation in the Standards of Appraisal Practice regarding fractional appraisals does apply to valuations of properties owned by a gas company. It has been in cases such as these where the misuse has been made of the summation method. The value of the land to a public utility is tied in definitely with the entire property. The land may have a higher value without the public utilities building erected thereon and to give it that value results in an erroneous appraisal.

Answering question Two, a real estate appraiser should refuse to value the land alone without a modifying clause. I do not feel that the particular invalidating clause is necessary but the value which is being determined by the appraisal should be defined and so stated in the appraisal. For example, he may value the land as if the building were not located thereon, provided he so states in the appraisal. There may be circumstances where the

public utility building would be on land too valuable for that type of development. This situation would be taken into consideration in valuing the entire property and accordingly the valuation of the land alone and the physical building would give an incorrect value.

Aside from these two specific questions, I believe appraisals of this nature are a great deal the same as those of industrial property such as warehouses. The basis to consider in making an appraisal is not necessarily the reproduction cost less physical depreciation but the cost of a building which would satisfactorily serve the needs at the present time. This might be a different type structure than that which exists today which would result in an element of obsolescence being taken into consideration. I will admit that State regulation may require a specific basis for appraisal so that this approach may not be possible.

Joseph B. Hall, M. A. I.

Cincinnati, Ohio.
February 22, 1933.

Report of Committee on Percentage
Leases

AS Chairman of the Committee to consider what methods should be used in determining and expressing

the profits from a property which is leased under a percentage lease I regret to advise you that the committee's report is incomplete. Only a few of the committee members cooperated to assist me. My personal opinion which is concurred in by Reidy, Apfelbaum, and Houghton is that while percentage leases of themselves are not new their use today is growing in favor. Our opinion is that until the experience has worked out for a number of years the only income that can be considered as income is that which has been received on the average over the period of the lease already past. My personal opinion is that percentage leases with a minimum guarantee on a fair basis are the best for both landlord and tenant and that in capitalizing rental the minimum rental should be used as the contract rental. Any rentals received in excess of the income can be used as additional income toward either sinking fund or amortization payments or as additional space rented. At the mid-winter meeting, I can make a complete report after having done more research work and completed the research work I have already undertaken.

Joel L. Schlesinger, M. A. I.

Newark, New Jersey.
June, 1933.



Rules Of Professional Ethics

Article I. Contingent Fees

SEC. 1. It is unethical for an appraiser to accept an order to appraise a property if his employment or fee is contingent upon his reporting a predetermined or specified amount of value, or is otherwise contingent upon any finding to be reported.

SEC. 2. It is unethical for an appraiser retained in cases where damages resulting from the exercise of the right of eminent domain, or resulting because of fraud, misrepresentation, etc., to make his compensation contingent upon the amount of, or to fix his compensation as a percentage of the damages which may be decreed by the Court deciding the issues in the case involved.

SEC. 3. It is unethical for an appraiser to accept an assignment to appraise a property when such assignment involves a bonus, a favor, or any special inducement other than a fair professional fee for the responsibility entailed and the work and expense involved. The schedule of charges for appraising adopted by the local member Real Estate Board is recognized as a proper standard of payment and should be followed. If there is no minimum fee established by the local real estate board, the fee should be reasonable for service rendered and within the bounds of good business practice. Taking advantage of a client discredits the entire real estate profession.

Article II. Commissions and Favors

SEC. 1. It is unethical for an appraiser to accept any commission, favor or emolument, in connection with the appraising of a property, other than a fair professional fee for the responsibility entailed and the work and expense involved.

Article III. Disinterested Appraisals

SEC. 1. It is unethical for an appraiser to issue an appraisal report if he is acting or intending to act in the capacity of broker, loan broker or manager, or if he has an ownership, contemplated future ownership, or any other interests in connection with the property appraised, unless such interest or interests be fully disclosed in the appraisal certificate.

Article IV. Independent Appraisals

SEC. 1. It is unethical for appraisers who have been retained to make independent appraisals of a property to collaborate or consult with one another with reference to the appraisal, or to make use of the findings or figures developed or reported by any appraiser so retained.

SEC. 2. It is unethical for appraisers who have been retained to collaborate in the making of an appraisal to issue separate appraisal reports on the property appraised. They should sign a joint report, or if there be dissenting opinions these opinions should be stated in the report rather than in separate documents apart from the report.

Article V. Hypothetical Appraisals

SEC. 1. It is unethical for an appraiser to issue an appraisal report on an investment construction project with such value predicted on assumed rentals and/or expenses at variance with the probable market at the time at which the reported value obtains.

SEC. 2. It is unethical for an appraiser to issue an appraisal report on an investment property based on an earning expectancy which does not **analyze** existing leases.

Existing leases, until their expirations may **apparently** increase or decrease the net earnings of the property above or below the net earnings which would be realized were the space rented at the market rates existent at the time the reported value obtains.

SEC. 3. It is unethical for an appraiser to issue an appraisal report in which the reported value is based on the completion of public or private improvements which are not assured unless he clearly states that the appraisal is made on that hypothesis. Provided that, in any event, he must state in his report the conditions with regard to such improvements which he assumes in determining the value reported.

SEC. 4. It is unethical for an appraiser to issue an appraisal report in which the reported value is based on the assumed absence of any legal restriction, unless such assumption is reasonable or in accord with legal opinion accepted by the appraiser, and unless the legal authority and his opinion are quoted in the

appraisal certificate, and it is expressly stated that the appraisal is contingent on such lawful restriction being changed or absent in accordance with the assumption.

Article VI. Fractional Appraisals

SEC. 1. It is unethical for an appraiser to issue an appraisal report on a fractional part of a property unless he specifically states that the value reported is invalidated if used in making a summation appraisal of the property as a whole.

SEC. 2. In appraising the security for a loan it is unethical for an appraiser to issue a certificate covering anything less than all of the property designated as security for the loan.

SEC. 3. In particular, in appraising the security for a leasehold loan, it is unethical for an appraiser to issue a certificate of value of the improvement only, omitting the value of the leasehold, which latter may be positive, zero, or negative.

Article VII. Summation Appraisals

SEC. 1. It is unethical for an appraiser to issue an appraisal report on a property in which the total reported value is derived by adding together the values of fractional parts of the property unless it is shown that no incompatible conditions were assumed in making the fractional appraisals.

SEC. 2. In particular, in appraising the security for a loan, it is unethical for an appraiser to issue an appraisal report on a property in which the total reported value is derived by adding together the market value of the land, (or leasehold) as if unimproved, or the value of the land (or leasehold) as if improved to the highest and best use, and the reproduction cost of the improvements less accrued structural depreciation, unless other and conclusive evidence is given that this result equals the total value of the property considered as a unit.

Article VIII. Economic Probabilities and Value of Investment Property

SEC. 1. It is unethical for an appraiser to issue an appraisal report on an investment construction project and report such value as of normal occupancy without also reporting the assumed date of normal occupancy and his estimate of net earnings or deficits during the period from completion to normal occupancy.

SEC. 2. If the value reported is the value which in the opinion of the appraiser will prevail when normal occupancy is attained, it is unethical for the appraiser to report the value as of any other than the date when it is assumed such normal occupancy will have been attained.

SEC. 3. It is unethical for an appraiser to issue an appraisal report on an investment construction project which does not give the appraiser's opinion on the economic soundness of the project, as measured by the difference between the estimated net cost up to the completion and the value at completion.

SEC. 4. It is unethical for an appraiser to issue an appraisal report on an investment construction project without also reporting his estimate of the reasonably expected earnings of the project upon completion as well as upon attaining the assumed normal average occupancy.

Article IX. Duty To Hold Findings Confidential

SEC. 1. It is the duty of an appraiser to hold as confidential the fact that he has been employed to make an appraisal, his results and other findings, until released from his obligation by the client or by due process of law.

Article X. Expert Testimony

SEC. 1. In giving testimony as to the value of real property in any court or before any other legally constituted tribunal an appraiser may follow rules of procedure as to appraisal method legally binding in that jurisdiction even though such rules may be at variance with the provision of these Standards.

Article XI. Contents of Appraisal Certificates

SEC. 1. It is unethical for an appraiser to omit any of the following from his appraisal certificate.

- A. An unequivocal and reasonably complete description of the property appraised.
- B. A statement of any contingent conditions upon which this appraisal has been based. For example: (a) the validity of legal, engineering, or auditing opinions used; (b) the completion of projected public or private improvements; (c) that the management will be competent and the ownership be in competent hands.

- C. A statement classifying the property appraised as an investment property, a non-investment property, or a service property.
- D. The date or time at which the value obtains.
- E. The amount of the value.
- F. A statement that the undersigned appraiser has no present or contemplated future interest in the property appraised; or a statement disclosing all such interests which the undersigned appraiser may have in the property appraised.
- G. In case the property appraised is a fractional part of the property of a type covered by these Standards of Practice, a statement that the value reported is invalidated if used in making a summation appraisal of the property as a whole.
- H. A CERTIFICATE, substantially in the following form:

I, (WE) the undersigned do hereby certify that to the best of my (our) knowledge and belief the statements and opinions contained in this appraisal certificate, subject to the limiting conditions herein set forth, are correct; also, that this appraisal has been made in conformity with the Standards of Practice of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards.
- I. A statement that the appraiser's employment is not contingent upon the amount of the value reported, and (in the event the appraisal is used in cases of litigation involving the fixing of damages caused by exercise of the power of eminent domain, or in cases in-

volved damages because of fraud, misrepresentation, etc.) is not contingent upon the amount of damages awarded by arbitrators or through judicial decree.

Article XII. Advertising

SEC. 1. It is unethical for a Member of the Institute to advertise his professional attainments or services through the mails, in the public print, by circular letters, bill boards, or window advertising, or by any other written word except that a Member may cause to be published in the public press what is technically known as a "card".

A card is hereby defined as an advertisement of the name, professional titles including M. A. I., (Member of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards) class of service, address of the advertiser, without any other qualifying words or letters or, in the case of announcement of change of address, the plain statement of the fact for the publication of which the announcement purports to be made.

Cards permitted by this rule when appearing in newspapers shall not exceed two columns in width and three inches in depth; when appearing in magazines, directories and similar publications, cards shall not exceed one-fourth page in size. This rule shall not be construed to inhibit the proper and professional dissemination of impersonal information among Member's own clients or personal associates or the properly restricted circulation of bulletins containing professional information.

SEC. 2. It is ethical, however, for an appraiser of the Institute to carry an announcement in the classified telephone directory as follows: "JOHN DOE, M.A.I., Address, Telephone Number" under the subdivision REAL ESTATE APPRAISALS.



Digest Of The Proceedings Of The Annual Convention

Tuesday Forenoon, June 13, 1933

The Institute convened in the Stevens Hotel, Chicago, Illinois, at 10:00 A. M., with Vice President Joseph B. Hall of Cincinnati, Ohio, presiding.

Mark Levy of Chicago, presented a demonstration appraisal on a leasehold estate. A general round table discussion followed.

The Nominating Committee recommended the following members for election to the Governing Council for the three-year term expiring December 31, 1936:

Harry E. Gilbert, Baltimore, Md.
Samuel C. Kane, Philadelphia, Pa.
Norman L. Newhall, Minneapolis, Minn.
E. L. Ostendorf, Cleveland, Ohio.
Frank H. Taylor, East Orange, N. J.
Fenwick B. Small, Brooklyn, N. Y.

For the term expiring December 31, 1935:
Cuthbert E. Reeves of Buffalo, N. Y.

For the term expiring December 31, 1934:
A. C. Houghton, Washington, D. C.

The chair announced that the election would take place at the afternoon session.

The meeting adjourned at 12:30 o'clock.

Tuesday Afternoon, June 13, 1933

The Institute convened in the Stevens Hotel, Chicago, Illinois, at 2:00 o'clock, with Vice President Joseph B. Hall of Cincinnati, Ohio, presiding.

The chair read a message from President Kniskern regretting his inability to be present at the convention.

John P. Hooker of Chicago, presented the financial history of a Chicago loop property for a period of twenty-five years. General round table discussion followed.

A. K. Hornof of Chicago presented a demonstration appraisal of a hotel property. General round table discussion followed.

The following members were elected to the Governing Council as indicated:

For the term expiring December 31, 1934:
A. C. Houghton, Washington, D. C.
For the term expiring December 31, 1935:
Cuthbert E. Reeves, Buffalo, N. Y.

For the term expiring December 31, 1936:

Harry E. Gilbert, Baltimore, Md.
Samuel C. Kane, Philadelphia, Pa.
Norman L. Newhall, Minneapolis, Minn.
E. L. Ostendorf, Cleveland, Ohio.
Frank H. Taylor, East Orange, N. J.
Fenwick B. Small, Brooklyn, N. Y.

The meeting adjourned at 4:30 o'clock.

Tuesday Evening, June 13, 1933

The Institute convened at a Dutch Treat Dinner in the Stevens Hotel, Chicago, at 7:30 o'clock, with Vice President Joseph B. Hall of Cincinnati, Ohio, presiding.

The first part of the program was devoted to a continued round table discussion of the demonstration appraisal of the Blank Hotel, presented at the afternoon session by A. K. Hornof.

The balance of the session was devoted to an informal address by J. Soule Warterfield of Chicago.

The meeting adjourned at 9:00 o'clock.

Wednesday Afternoon, June 14, 1933

The Institute convened in the Stevens Hotel, Chicago, at 2:15 o'clock, with Vice President Joseph B. Hall of Cincinnati, Ohio, presiding.

Clarence C. Lang of St. Louis, Missouri, presented a paper prepared by W. W. Butts of the same city, under the title "Regaining the Confidence of American Investors."

The chair announced that President Kniskern had appointed a special committee headed by A. C. Houghton of Washington, D. C., to maintain contact with the United States Chamber of Commerce with reference to the working out of proposed consolidated appraisal reports.

Ivan A. Thorson of Los Angeles, California, delivered an address on "The Realtor Appraiser's Great Opportunity". A general round table discussion followed.

Joseph B. Hall, Chairman of the Committee on Appraisal Procedure, presented an informal report, recommending that more time be allowed for study before adopting standard definitions and procedure.

A report from the Committee on Ethics was presented and approved. (This report is given in full on page 368.)

A report from the Committee on Valuation of Percentage Leases was presented and approved. (This report is given in full on page 367.)

The meeting adjourned at 4:30 P. M.

Wednesday Morning, June 14, 1932

The Governing Council convened in the Stevens Hotel, Chicago, at 10:00 A. M., with Vice President Joseph B. Hall of Cincinnati, Ohio, presiding.

Minutes of the meetings held in Washington, D. C., were read and approved.

A letter from Stanley McMichael of Los Angeles, with reference to examination of candidates was read and tabled.

Letters from J. Mortimer Clark of Long Beach, California, and Charles R. Wright of Fergus Falls, Minnesota, with reference to the admission of farm land appraisers, were read and referred to the By-Laws Committee with instructions to amend Article II, sections c. and d. of the By-Laws to provide for admission of farm land appraisers, and with instructions to the Admissions Committee to work out qualifications for admission.

A. C. Houghton of Washington, D. C., presented a report on a meeting held at the headquarters of the United States Chamber of Commerce in Washington, D. C., on May 3, 1933, for the purpose of having appraisals mentioned in the Securities Act. It was moved, seconded, and carried that Mr. Houghton continue as Chairman of the special committee to keep in touch with developments along the lines discussed at the Chamber of Commerce meeting.

It was moved, seconded and carried, that the Membership Committee attempt to secure the cooperation of member Boards of the National Association of Real Estate Boards in recommending all qualified applicants to the Institute irrespective of their class of local board membership.

A letter from William H. Ballard of Boston, with reference to building planning service, was read and referred to Mr. Houghton's Committee for consideration.

The following membership report was read and approved.

1. Number of Members May 31, 1933.....181
2. Number of Affiliates with dues paid in full to May 31, 1933.....165
3. Number of delinquent Members as of June 1, 1933..... 8

4. Number of delinquent Affiliates as of June 1, 1933..... 37

It was moved, seconded and carried, that the By-Laws Committee be instructed to prepare amendments to the By-Laws to cover expulsion, suspensions, and re-instatement.

It was moved, seconded and carried, that the Membership Committee be instructed to notify delinquent Affiliates that when they are ninety days in arrears in the payment of dues, they will be dropped from the membership roll.

It was moved, seconded, and carried, that the same general procedure be followed with reference to delinquent Members as is followed by the National Association of Real Estate Boards in dealing with delinquent member Boards. It was also decided to ask members of the Governing Council personally to contact delinquent Members in their respective territories.

The following financial report was read and approved:

Receipts to May 31, 1933:

1. 1932 membership dues received in 1933	\$ 3.30
2. 1933 membership dues	2,226.59
3. Membership dues held on deposit on behalf of candidates.....	564.58
4. Examination—membership fees	105.00
5. Revenue from settlement of book account .....	.08
6. Revenue from sale of standard forms	6.65
7. Revenue from sale of emblems	9.00
8. Revenue from subscriptions and sale of Journal	646.70
9. Miscellaneous revenue	4.86

Total Receipts to May 31, 1933.....\$3,566.76

10. Plus surplus as of January 1, 1933	2,966.13
	<hr/> \$6,532.89

Expenses to May 31, 1933:

1. Dues—refunds	\$ 10.00
2. Transfer of dues on deposit.....	240.00
3. Membership investigations	15.04
4. Journals	2,003.36
5. Miscellaneous printing	221.66
6. Special bulletins	13.52
7. Salaries	1,512.97
8. Miscellaneous travel	40.00
9. Rent	231.28
10. General miscellaneous	83.83
11. General postage	52.78

Total Expenses to May 31, 1933.....\$4,424.44

Bank Balance as of May 31, 1933.....\$2,108.45

Harry E. Gilbert of Baltimore, Maryland, on behalf of the Admissions Committee, presented a report recommending the admission of the following individuals to the Member grade:

Harry J. Wood, Fort Myers, Florida.
 Harry S. Cutmore, Chicago, Ill.
 Arthur S. Kirk, Des Moines, Iowa.
 James A. O'Connell, New Brunswick, N. J.
 Arthur J. Horton, Brooklyn, N. Y.
 George S. Horton, Brooklyn, N. Y.
 William F. MacDermott, Jamaica, L. I., N. Y.
 Granville H. Rome, Jamaica, L. I., N. Y.
 K. Lee Hyder, Milwaukee, Wisconsin.
 David W. Bush, Los Angeles, Calif.
 George L. Schmutz, Los Angeles, Calif.
 Mark Cheesman, Sacramento, Calif.
 George Robert Quin, Chicago, Ill.
 Walter S. Palmer, Grand Rapids, Mich.
 John H. Farish, St. Louis, Mo.
 Harry J. Stevens, Newark, N. J.
 M. C. O'Brien, Brooklyn, N. Y.
 C. S. Noble, Winston Salem, N. C.
 Ernest H. Lyons, Chicago, Ill.
 Ivan A. Thorson, Los Angeles, Calif.
 Curtis Walker, Washington, D. C.
 Samuel C. Ennis, Hammond, Ind.

Two other individuals were recommended for admission conditionally, subject to further investigation and favorable reports.

The Committee presented the names of nine other individuals who had filed application for admission but whose application files were incomplete and recommended that action be deferred. It was so ordered.

It was moved, seconded and carried, that a special Committee be appointed to confer with the Appraisal Committee of the Chicago Real Estate Board with reference to the formation of an Illinois Chapter of the Institute.

The meeting adjourned at 1:00 P. M.

Wednesday Afternoon, June 14, 1933

The Governing Council convened at 4:30 P. M. with Vice President Joseph B. Hall of Cincinnati, Ohio, presiding.

Harry E. Gilbert, on behalf of the Committee on Examinations (a sub-committee of the Admissions Committee) presented a report recommending a specific standard procedure in the giving of examinations. The report of the Committee was unanimously approved.

It was moved, seconded and carried that the Admissions Committee set a date on and after which candidates for admission to the Member grade be required to take examinations.

It was moved, seconded and carried, that local chapters giving examinations shall do so through the Admissions Committee of the American Institute of Real Estate Appraisers.

On behalf of the Committee on Appraisal Procedure, Joseph B. Hall presented a report recommending more time for a study of current literature and discussion of various viewpoints before preparing definitions and outlining general principles of practice. The report was unanimously approved.

A report was presented from the Committee on Ethics of which Ralph D. Baker of Camden, New Jersey, is Chairman. With some slight modifications, the report was unanimously approved. (See page 368 for Rules of Professional Ethics as adopted.)

The By-Laws of California Chapter No. 5, and the By-Laws of Ohio Chapter No. 3, were presented by J. Alvin Register, of Jacksonville, Florida, on behalf of the Committee on Local Chapters. On motion duly made, seconded and carried, these By-Laws were unanimously approved.

Mr. Register was instructed, as Chairman of the Local Chapters Committee, to communicate with Members of the Institute in the Metropolitan Area of New York City with reference to the organization of their Chapter.

Bracton Goldstone, Chairman of the Membership Committee, announced that Maurice F. Reidy of Worcester, Mass., Arthur S. Kirk of Des Moines, Iowa, and Frank McLaughlin of Toronto, Canada, had been added to his Committee. He stated that the Membership Committee is now obtaining a list of qualified expert appraisers in states that have no representation in the American Institute of Real Estate Appraisers and that an effort will be made to secure applications from one or two such qualified expert appraisers in each of these states before the next meeting of the Institute. The report of the Membership Committee was unanimously approved.

E. L. Ostendorf, Chairman of the Committee on By-Laws, presented, in due form, the following proposed amendment to Article XIII:

"Section 4: It shall be the sole right of the Governing Council to divide or subdivide the territory included in the jurisdiction of any chapter if and when such action may be deemed advisable. In the establishment of new chapters made up from the territory of former chapters, there must be at least 15 members, providing, however, that the found-

ing of the new chapter shall not reduce the membership of the original chapter below the minimum of 15 members.

"Excepting for this said restriction, nothing within this section shall be interpreted to mean that any new chapter or chapters may not include one or more members who were formerly members of the chapter from whose territory the new chapter is created."

On motion duly made and seconded, the proposed amendment was unanimously carried.

Mr. E. L. Ostendorf, Chairman of the Committee on By-Laws, presented a proposed amendment to Article IV. This proposed amendment was by unanimous vote referred back to the By-Laws Committee for revision.

E. L. Ostendorf, Chairman of the Committee on By-Laws, presented a proposed amendment to Article IX. On motion duly made and seconded, the proposed amendment was rejected.

The following report, submitted by the Publications Committee, was approved:

REPORT OF PUBLICATIONS COMMITTEE

1. Detailed financial statement for "The Journal of the American Institute of Real Estate Appraisers"—Sept. 1, 1932-June 1, 1933.

Sale of single copies, subscriptions (156), and \$5.00 each from each Member and Affiliate, deducted from dues paid—1932.....		Receipts	
—1933.....			Expenses
		\$2,453.75	
		646.70	
Copyrighting			\$ 6.00
Editorial expense			75.00
Postage — mailing circulars and Journals			402.75
Printing of Journals—			
	October	\$998.00	
	January	876.00	
	April	785.00	
			2,659.00
Wrappers for Journals			53.75
Circulars and subscription blanks.....			122.00
Refunds and N.S.F.'s			25.45
		\$3,100.45	\$3,343.95
Net Deficit			243.50
1932		1933	
Receipts	\$2,453.75	Receipts	\$ 646.70
Expenses	1,340.59	Expenses	2,003.36
		Deficit	\$1,356.66
Balance	\$1,113.16	Net Deficit	\$ 243.50

On motion duly made and seconded, the following officers were elected for the calendar year 1934:

President—Philip W. Kniskern, New York City, N. Y.

Vice President—Joseph B. Hall, Cincinnati, Ohio.

On motion duly made and seconded, it was unanimously decided that local chapters shall be designated as "New Jersey Chapter No. 1", "Florida Chapter No. 2", "Ohio Chapter No. 4", "California Chapter No. 5", etc.

It was ordered by unanimous vote that the Institute issue pocket membership cards of standard size, similar to the one submitted by the Director of Activities, but giving no indication of Chapter affiliation.

It was unanimously decided that the Insti-

tute shall not make membership contingent upon research contributions.

On motion duly made and seconded, it was unanimously carried that the annual meetings of the Institute shall be held immediately preceding the opening of the Annual Meetings of the National Association of Real Estate Boards, and that, if possible, the Governing Council shall meet preceding the opening of the meetings of the Institute.

A proposition for special publicity was submitted by Mr. Ostendorf and referred to the Publications Committee.

A vote of thanks was given to the Chicago Real Estate Board, its officers and all others whose many courtesies helped to make the annual convention a success.

The meeting adjourned at 6:00 P. M.



Chapter News

New Jersey Chapter No. 1

An all-day state institute on some central appraisal problem is planned for the fall by New Jersey Chapter Number 1 of the American Institute of Real Estate Appraisers, Morris Goldfarb, president of the New Jersey Chapter, reports. The Chapter, which works very closely with the New Jersey Association of Real Estate Boards, conducts one-day institutes also in connection with the state real estate convention. The latter institute is open to all Realtors.

Many members of the New Jersey Chapter were recently called upon to report either for the State of New Jersey or the railroads in an important tax appeal case.

The Chapter has made an industrial tour of northern New Jersey. The seven piers owned by the United States Shipping Board, located at Hoboken, were a special point of interest in the tour. A demonstration appraisal of the piers was made by Percy A. Gaddis.

The proposed seaboard terminals to be erected at Bayonne on the New York Bay were discussed, as were other seaboard terminals. The appraisers went into rental value, vacancy ratio and the like. The same kind of study is planned for the Camden and Philadelphia areas on the Delaware River.

The method of appraising waterfront properties on the Hudson River has considerably changed in the past year through study by organized appraisers. A front foot method now takes the place of the rough acreage method; depth of water at the pierhead line, distance between pierhead line and bulkhead line, the amount of backland available, railroad facilities, road facilities, labor market, methods of distribution and transportation, size, shape and area, all of these are factors that have a bearing on value of waterfront properties.

Ohio Chapter No. 3

A general plan for state advancement in appraisal practice will be put into effect this year in Ohio through active co-operation of Ohio Chapter No. 3 of the Institute and the Ohio Association of Real Estate Boards, according to Lewis R. Smith, secretary of the

Ohio Chapter. Two state meetings per year are to be scheduled for the Chapter. Individual members of the Chapter are getting together facts as to real estate conditions in the Chapter's territory, so that these facts will be available for all current appraisal work.

"Wherever the opportunity presents itself, we are getting the message of the M. A. I. to local real estate boards, discussing with their outstanding members their availability for memberships and affiliates," Mr. Smith writes.

Committees appointed by President Walter S. Schmidt are as follows: (1) Committee on Standards of Practice: Jos. B. Hall, Chairman, Howard Etchen, E. L. Ostendorf; (2) Membership Committee: Jos. Laronge, Chairman, W. F. Voges, Mark Hambleton; (3) Program Committee: John B. Spilker, Chairman.

California Chapter No. 5

A close affiliation has been established between the California Chapter Number 5 of the Institute and the Appraisal Division of the California Real Estate Association, according to Stanley L. McMichael, president of the Chapter, and Nathan Libott, secretary. J. Mortimer Clark, chairman this year of the state Appraisal Division, a member of the California chapter, hopes that many of his divisional members ultimately will graduate into the Institute.

It is the policy of the California Chapter, for the present at least, to mimeograph for the use of every member talks given at the monthly Chapter meetings. Subjects are assigned sixty days in advance. The Chapter is building up in this way its own library of appraisal ideas and information.

"The influence of the Institute is making itself felt in the selection of appraisers for projects being financed by government funds," Mr. McMichael writes. "In the recent appraising done for loans to earthquake sufferers at Long Beach, Institute members were given preferred positions because of their qualifications. Members of a local board supervising the distribution of the money stated that the class of work done had, in their estimation, never been excelled."



Book Reviews

Donald B. Woodward and Marc A. Rose, INFLATION. Whittlesey House, McGraw-Hill Book Company, Inc., New York, 1933. 165 p. \$1.50.

APPRECIATING the need for an impartial, unbiased explanation of the important current subject "Inflation", the authors of this work have made a real contribution. The contribution consists not so much in the material but rather in the frank, clear, understandable manner it is presented.

The demand and supply of money is just as important as the demand and supply of tangible goods. Bank credit, which makes up a large part of our money, has shrunk very materially in recent years. The result is dear money and cheap commodities. Business based on credit cannot be carried on successfully when debts must be paid with dear money. The situation becomes complicated when nearly everyone is both creditor and debtor. Owners of life insurance policies are creditors because their premiums are used to purchase investments, and the investments are obligations of the creditors.

Many people think inflation means a general rise in prices or improvement in business conditions. This in general may be the result, but in this discussion "Inflation" means "the manipulation or control of money to the end of decreasing its value, that is, of raising broad price averages".

Troubles with money, inflation and deflation are not new. The Romans had their problems and in later years the American colonies and the United States had difficulties in a society much less complex than our present one. Germany's debacle is still first in our minds. There were other problems during the World War, overshadowed perhaps by the tragedies.

The United States in 1929 was ripe for an upheaval. In 1834, the average amount of money used per capita was \$12.35—\$5.24 in coin and currency and \$7.11 in bank deposits. In 1930, the relationship was \$29.76 in cash and \$485.57 in bank deposits. This indicates not only the great increase in the use of money, but also how much of our medium of exchange is the banker's promise to pay. This condition coupled with the complexity of our economic lives made the last few years much worse than anyone anticipated. With debts comprising a large share of our money, and many not able to pay debts, people began to

lose confidence. The bank moratorium and governmental action are results.

Of course, the general cry is to reduce debts. This is a difficult task. An easier way is to increase prices. If prices increase volume of business will automatically increase. Everybody spends more and debts will be met with much less difficulty.

One question is, how to raise prices, and if raised, how to control them. If they are not controlled, money will become worthless. Another question is, how to make the rise in prices affect everyone. Farmers will be helped only temporarily if laborers do not receive higher wages. This is the problem of inflation. If it could be worked long enough to help everybody and stopped before it hurt everybody, our financial problems would be solved. But economics is a behavioristic science and consequently there can only be tendencies.

One plan is to restrict the supply of goods and therefore raise prices. The restriction theory is bad for several reasons. It is unethical, and even more important, it defeats itself. It is a vicious circle. To restrict one crop may help the price, but to restrict all of them would mean that everyone was trying to profit at the expense of everyone else.

Demand seems to be insatiable; that is to say, human beings are never completely satisfied. So there is no relief on the demand side.

It seems difficult, therefore, to manipulate goods. The only thing left is money. At first blush that seems easy. There are obstacles, however. First, money must increase faster than volume of trade otherwise prices will fall again. Second, the money must be put to work—people must spend. Third, the things people buy must be consumed. Speculation means only temporary relief, for at some future time everyone will want to take their profits and prices will crash. And finally, there is the problem of spreading the benefits of rising prices equitably. Will the bank clerk's wages keep up with the rise in cost of living or will he be pressed to eke out an existence in the lag. These are the real problems of inflation.

Inflation on the gold standard requires an increase in gold stocks or Federal Reserve credit, confidence of most of the people, and faith in money. Bankers and business men must have faith in the future. Without this

faith, sooner or later there is a rush for gold and the whole monetary system is wrecked.

Changing the gold basis of the dollar and bimetallism have been advanced as methods of inflation. They both have serious defects. Among other things, it would be difficult to gain confidence in a government's money when the government had just repudiated its promise. Bimetallism could not work when so few countries use silver as a standard of value.

When a government goes off the gold standard, people cannot exchange money for gold. This in itself does not produce inflation. But sooner or later, people exchange money for tangible goods they can consume and prices begin to rise. "The inflation is on, and temporarily, at least, everybody is happy. How long people will be happy depends on how well the inflation is controlled. If it affects everyone equitably and does not run amuck great good will have been done. These are big "ifs" which time only can determine.

The conclusion then is that inflation must be controlled. Governments should be able to control it especially if they plan it. Deflation under our monetary system is intolerable—it may possibly lead us to another Dark Age. It is not a choice of good or evil. It is a choice of the lesser of two evils. Certainly inflation properly controlled is better than deflation. But let us reiterate, economics is a behavioristic science, and consequently there are many pitfalls along the way.

H. O. Walther.

Chicago, Illinois, July 10, 1933.

Henderson, James D., **POCKET MANUAL FOR APPRAISING REAL ESTATE.** Cambridge. Banker & Tradesman Publishing Co. 1932. 64 p. \$1.00.

FROM the title of Mr. Henderson's book you will immediately perceive that it is not intended as a monumental writing. To quote from its own preface, "it is an attempt to present in small compass and convenient form, statistics, reference tables, and other data useful to the appraiser". In this attempt, I should say, it is highly successful. Its convenient size and the concise manner in which its contents are presented recommend its regular use.

In addition to a very complete glossary of appraisal and building terms, the book contains many pages of information useful not

only to the experienced appraiser, but to the student and the general real estate broker as well. Indices of comparative construction costs and of real estate activity, a condensed tabulation of the estimated economic life of buildings by the U. S. Treasury Department, a percentage table applicable to practically every line of retail merchandising, and other similar data make this book useful to others than appraisers. For those whose principal interest is in the appraisal field, the book contains much valuable data, for example, as to the various methods which have been evolved for depreciating buildings, cubing and squaring buildings, discount tables, and several enlightening pages of comment, court decisions, etc., from all over the country upon the much-discussed term, "market value".

In my opinion, this book will be found to be a handy, useful addition to the Realtor-Appraisers library.

Stanley Roe.

Chicago, Illinois, June 29, 1933.

Hurd, Richard M., **PRINCIPLES OF CITY LAND VALUES.** New York: The Record and Guide Pub. Co., 1924. Fourth edition. 159 p. \$3.50.

THIS book first appeared in 1903 and has been rewritten in three editions since that time—1905, 1911, and 1924. Although it is one of the earliest books to be published on city growth and values, it has lived through the years as one of the most valuable contributions to the appraiser's library. In spite of the fact that the first edition appeared 30 years ago, it is still considered to be the outstanding publication in this field and is of great value to all appraisers specializing in urban property. The scope of the book is shown by the chapter headings:

- General Principles
- Forces Creating Cities
- Locations of Cities
- Ground Plan of Cities
- Directions of Growth
- Distribution of Utilities
- Currents of Travel
- Types of Buildings
- Rentals and Capitalization Rates
- Scale of Average Values
- Summary.

The author states that the materials for the study of the structure of cities—including their locations, starting points and lines of growth—were gathered from a large number of local histories of American cities, old maps,

commercial geographies, etc. The material for the study of average scales of values was drawn from the mass of valuations of land and buildings, rentals and mortgages, obtained in about fifty cities in the course of the mortgage business of the U. S. Mortgage and Trust Company, The Lawyers Mortgage Company, the Mortgage Bond Co. of New York and also from many visits to these cities.

The value of the book is further increased by the numerous illustrations included. Nearly every page includes a map or picture explaining the text.

Two of the most interesting chapters in the book are the first chapter outlining general principles of value and the fifth chapter which considers directions of city growth. In the first chapter Mr. Hurd states that economic rent is the residuum after payment of all charges and interest on buildings. Ground rents are paid for some sites and not for others in general because of the difference in desirability. The difference in desirability is based on the social service which different sites render, or conversely, the sacrifice which they save.

In the chapter on directions of city growth Mr. Hurd discusses the central axial and star-shaped growth of cities and sketches the influences of water courses, turnpikes and railroads in outlining the framework of cities.

C. M. Jones.

Chicago, Illinois, July 1, 1933.

Donald B. Woodward and Marc A. Rose, A
PRIMER OF MONEY, McGraw-Hill
Book Company, Inc., Whittlesey House,
New York and London, 1932. \$2.00.

THIS primer contains a very brief statement of the principal problems in the field of money and banking. It has only 216 small pages of rather large printing and consequent-

ly does not go into any detail, but the problems are stated with exceptional perspicacity and simplicity. Only the principal problems come in for any attention.

The text is well written and has a number of intriguing and illuminating illustrations. An excellent appendix contains a glossary of terms, typical bank statements, and a list of different types of United States money with a statement of the amount in circulation as of December 31, 1931. A list of readings is suggested, which anyone wishing to pursue the subject can follow with a great deal of benefit.

In view of the fact that this book was written before the bank holiday, its analysis of problems is all the more interesting, for very few lines in the book would probably be changed by the authors if they were rewriting after the holiday.

There is no attempt in the book to prescribe panaceas or to be dogmatic as to the controversial issues which are raised. It begins with a simple statement on the beginnings of money and monetary standards and proceeds to a discussion of the gold standard, interest, the rise of bank credit, central banking, and the Federal Reserve. These chapters describing banking machinery are followed by chapters on exchange and the money market and by Part II, consisting of a discussion of money problems in the modern world. It is in the second part that the authors are concerned with the application of the machinery which they have described in the first part and with the difficulties which this machinery meets in operation.

The book will well repay the time it takes to read it.

Ernest M. Fisher,

Professor of Real Estate, School of Business
Administration, University of Michigan.



Current Articles

- Actual Appraisal Reports. N. R. E. J. April 1933, p. 29. \$1.20. Valuation for reorganization purposes of seven-story kitchenette apartment building in Chicago.
- An Analysis of Building Costs in New York City. PETER A. STONE. R. & B. G. June 17, 1933, p. 3. \$0.70. Present cubic foot building costs range from 20 cents for frame attached residences to 70 cents for first class office construction.
- Can the Standard Gold Clause Be Enforced? JOSEPH F. MANN. S. M. May 1933, p. 15. \$0.45. Counsel for the National Association of Building Owners and Managers reviews the legal background of a much debated subject.
- The Gold Clause in Private Contracts. GEORGE NEBOLSINE. Y. L. J. May 1933, p. 1051. \$1.00. A detailed study of the legal effect of the gold clause including the legal rights of parties under debt contracts carrying ordinary currency clauses and a consideration of possible alternative measures of debt obligations available to future contracting parties.
- Height Limits for Tall Buildings Based on Plot Area. J. FELD. E. N. R. March 9, 1933, p. 315. \$0.45. Discussion of economic height of buildings based on a survey of 331 residential and office buildings in New York City, of 20 or more stories in height; the approximate formula against the number of stories is equal to the area of the plot divided by 700.
- Mass-produced Houses in Review. F. April 1933, p. 52. \$1.20. A review of the progress of the prefabricated house.
- May Survey of Rental Conditions Reveals 26.87% Average Vacancy. MURRAY E. RANDELL AND GEORGE W. KLEIN. S. M. June 1933, p. 6. \$0.45. Survey covers 1,929 buildings in 42 cities.
- Measuring the Value of an Easement. A. J. ROSENFELD. N. R. E. J. March 1933, p. 33. \$1.20. "The author's purpose is not to set forth the final word on the matter, but to call the attention of Realtors to the need for a fuller consideration of this and other 'legal phases' of appraising."
- Methods of Industrial Appraisal. LOUIS B. BEARDSLEE. R. E. April 15, 1933, p. 11. \$0.30. "Result arrived at by adding value of land to replacement cost of the improvements should approximate evaluation from rental capitalization."
- Obsolescence and the Assessor. JOHN E. BURTON. J. L. E. May 1933, p. 109. \$1.45. Mr. Burton is a Lecturer in Land Economics, Northwestern University, formerly Research Secretary, Committee on Taxation, President's Conference on Home Building and Home Ownership.
- Population Trends and the Growth of Cities. W. RUSSELL TYLOR. C. E. May 1933, p. 277. \$0.70. A study of birth and mortality rates in which Professor Tylor develops the reasons for expecting a stationary state of population for the United States in the near future. The author is Assistant Professor of Sociology, University of Illinois.
- Stabilizing Real Estate Values. LAWRENCE B. CUMMINGS. R. & B. G. February 25, 1933, p. 3. \$0.70. Mr. Cummings is Vice-President of the Douglas L. Elliman & Co., Inc.
- A Technique for Establishing Relative Values of Realty. PETER A. STONE. R. & B. G. May 27, 1933, p. 3. \$0.70. Developed by the Committee on Land Utilization of the New York Building Congress, with the aid of workers from the Emergency Work Bureau under the direction of Thomas S. Holden and Arthur C. Holden.
- What Will "Inflation" Do to Office Building Earnings? S. M. May 1933, p. 9. \$0.45. The author of this article sees danger ahead if inflation is not firmly controlled.

The full names of the magazines indicated by initials on these pages are given below:

C. E.	Civil Engineering	Monthly
C. P.	City Planning	Quarterly
E. N. R.	Engineering News-Record	Weekly
F.	Fortune	Monthly
J. L. E.	Journal of Land and Public Utility Economics	Quarterly
N. R. E. J.	National Real Estate Journal	Monthly
R. & B. G.	Real Estate Record and Builders Guide	Weekly
R. E.	Real Estate	Weekly
S. M.	Skyscraper Management	Monthly
Y. L. J.	Yale Law Journal	Monthly

Copies of the magazines in which these articles appear may be secured from the Library of the National Association of Real Estate Boards, 59 East Van Buren St., Chicago, Ill. The price listed includes the price of the magazine and a small service charge for mailing and postage. Subscriptions may also be placed with the National Association.

New Members

At the Regular Quarterly Meeting of the Governing Council, held in Chicago, Illinois on June 14, 1933, the following were elected to the grade of Member in the American Institute of Real Estate Appraisers:

David W. Bush, Los Angeles, California

Born in Philadelphia, Pa.; active member, Los Angeles Realty Board; doing business under his own name in general real estate and appraising, professional territory covers Southern California; six years experience as civil engineer on construction of Philadelphia and New York subway systems; four years experience as civil engineer and superintendent on State highway, irrigation and dam construction in California; nine years experience as land appraiser with the Southern Pacific Co. in connection with the valuation of the railroads by the Interstate Commerce Commission (these appraisals covered all classes of property); during the past eight years has been in the real estate appraisal business on his own account, having appraised 1,881 parcels of land with a total valuation in excess of \$168,000,000 for the city of Los Angeles (including leaseholds); his appraisal experience includes also the appraising of more than 300 pieces of property for the County of Los Angeles, including urban and rural lands; five other condemnation proceedings involving 316 parcels of property; 219 parcels of property for the Superior Court; and 125 parcels of property for private owners in various parts of the City of Los Angeles.

George Le Roy Schmutz, Los Angeles, California

Born in Cumberland, Maryland; member, Los Angeles Realty Board; valuation engineer and lecturer on appraisal subjects; member, Faculty of Civic Center College of University of Southern California; professional territory covers the State of California; former member, American Institute of Mining and Metallurgical Engineers; former member, American Society of Military Engineers; co-author of "Economic Approach to Valuation Procedure"; author of course in "Condemnation Appraising" for the University of Southern California; author of article on "Economic Effects of Zoning" in Annals of American Academy of Political and Social Science;

ten years experience in the appraisal of real estate, covering commercial property, small and large homes, industrial property, apartments, etc.

Ivan A. Thorson, Los Angeles, Calif.

Born in Rochester, Minn.; President, Ivan A. Thorson Organization; Vice-President and Chairman of the Executive Committee, Bankers Trust & Savings Bank; professional territory—not limited; real estate counsellor and appraiser, Los Angeles Realty Board; teacher, author, and lecturer; actual appraisal experience in Los Angeles covers a period of nine years.

Mark Cheesman, Sacramento, California

Born in San Francisco, Calif.; assistant sales manager, Robertson-Govan Co.; appraiser, Robertson-Govan Co.; professional territory covers the City and County of Sacramento and adjoining territory; commissioner, opening of Y. Street, City of Sacramento; affiliate member, Sacramento Real Estate Board; four years as assistant buyer, Hale Brothers; graduate of course in merchandising; three years experience as real estate salesman for Wright & Kimbrough and Robertson-Govan Companies; one year's experience as assistant sales manager, Robertson-Govan Co.; graduate of general real estate course, University of California; graduate of real estate appraisal course, University of California; daily intensive appraisal work in Sacramento since 1929.

Curtis Walker, Washington, D. C.

Born in Washington, D. C.; official appraiser, Maryland National Capital Park and Planning Commission; Vice-President, chairman of appraisal committee, and director, Prudential Building Association; director, Silver Spring National Bank; Vice-President, Maryland Publishing Co.; chairman, Membership Committee, Washington Real Estate Board, 1926 and 1932; active member, Washington Real Estate Board; professional territory covers Washington, D. C., and suburban Maryland and Virginia; 10 years experience in real estate appraising; formerly associated with John F. Maury (Past President, Washington Real Estate Board); active in real estate field since 1923; appraisal experience includes residences, club property, coal and material business, retail property, office

buildings, bank buildings; appraised more than \$1,000,000 worth of residences in Washington, D. C. and suburban Maryland for various loan companies between 1924-1928; appraised more than \$2,000,000 worth of property for the Reconstruction Finance Corporation during the period 1931-1933.

Harry J. Wood, Fort Myers, Florida

Born in Live Oak, Florida; active member, Fort Myers Realty Board; Treasurer, Past President, and chairman, Appraisal Committee, Fort Myers Realty Board; Vice-President, Florida Association of Real Estate Boards; graduate of appraisal course of the National Association of Real Estate Boards; vice-president, Fort Myers Building & Loan Assn.; professional territory covers Lee County, Fla. and southwest Fla.; graduate of Georgia Tech in electrical engineering; chairman, Fort Myers Planning and Zoning Commission, 1925-1928; director, Fort Myers Chamber of Commerce, 1926-30; director of Jacksonville Real Estate Board and member Appraisal Committee, 1920-23; appraisal experience includes the valuation of homes, apartments, light and power plants, offices, warehouses, acreage, bank buildings, etc.

Harry S. Cutmore, Chicago, Illinois

Active member, Chicago Real Estate Board; President, Harry S. Cutmore and Associates, Inc.; in general appraisal business for 16 years; 6 years with the American Appraisal Company; director of 1928 re-assessment of all property in Cook County, Illinois.

Ernest H. Lyons, Chicago, Ill.

Born in Chicago, Ill.; associated in real estate and appraisal work with Thomas J. E. Kemp; professional territory covers the metropolitan district of Chicago; active member, Chicago Real Estate Board; 30 years experience in the appraising of real estate; active real estate experience in sales, leases, loans, subdivisions, construction of buildings and management of properties; formerly member and general chairman of Valuation Committee of the Chicago Real Estate Board; formerly Chief of Staff for the Board of Local Improvements, City of Chicago; during the period 1903-1933 appraised all types of property for such clients as the U. S. Government; Boards of Education; Park Boards; Railroads; City of Chicago, Inheritance Tax

Department; Banks; Trust Companies; various law firms; and individuals.

George Robert Quin, Chicago, Ill.

Born in Chicago, Ill.; business manager, Central Realty & Inv. Co., operating large office buildings in the Chicago loop and dealing also in lofts and other business properties; professional territory comprises the central business district of Chicago; director, Building Managers' Assn. of Chicago; director, Euclid Realty Trust; chairman, Tax Committee of State Street Council; active member, Chicago Real Estate Board; active as a real estate broker and manager since 1911; formerly member of Milburn & Quin in which connection confidential appraisals for S. W. Straus' larger business properties were handled from 1911-1916; appraisal experience includes office buildings, leaseholds, loft buildings, shops, professional buildings, retail store buildings, etc.

Samuel C. Ennis, Hammond, Indiana

Born in West Virginia; active member of the Hammond Real Estate Board; President, Mortgage Bond Service Company, Hammond; professional territory covers Northern Indiana; appraisal experience covers a period of seven years and includes the appraising of residences, commercial properties, apartment properties, industrial properties, and vacant properties; completed a two year course in real estate offered by the Chicago Real Estate Board at the Central College of Commerce in Chicago; special training at Valparaiso University.

Arthur S. Kirk, Des Moines, Iowa

Born in Hiawatha, Kansas; senior member and Past President, Des Moines Real Estate Board; Past President, Iowa Association of Real Estate Boards; secretary and treasurer, Chamberlain, Kirk & Company, Inc.; professional territory covers Des Moines and Iowa; Phi Beta Kappa, Gamma of Iowa; member, Finance Committee of Des Moines Club; member, Board of Directors, Wakonda Country Club; member, Board of Directors, Hermit Club; chairman, City Plan & Zoning Commission, 1932; chairman, Streets & Boulevards Committee, 1933; member, Iowa State Bar; member, Board of Trustees, Drake University; member, Investment Committee, Drake University; past chairman, Appraisal Committee, Des Moines Real Estate Board; B. A. degree, Drake University, 1914; A. M. degree, Harvard University, 1915; L.L.B. de-

gree, Law College, Drake University, 1923; actively engaged in real estate business since 1916.

Walter S. Palmer, Grand Rapids, Mich.

Born in Grand Rapids, Mich.; manager, Federal Square Building; appraiser, Equitable Life Assurance Society; Treasurer, Ravenswood Development Company; chairman, Grand Rapids Real Estate Board Appraisal Committee; member, National Association of Building Owners & Managers; director, Grand Rapids Association of Building Owners & Managers; director, Family Service Association of Grand Rapids; director (in charge) Legal Bureau of Grand Rapids; active member, Grand Rapids Real Estate Board; practiced law from 1912 to 1917 specializing in real estate; actively engaged in real estate business since 1923; actively engaged in real estate appraisal work during the last three years; graduate, University of Michigan Law Department, 1912; residential appraisals aggregate \$1,180,450; industrial appraisals aggregate \$1,244,345; condemnation appraisals aggregate \$466,076; commercial and investment appraisals aggregate \$710,962; appraised, as member of real estate board appraisal committee, appraisals aggregating in value \$5,012,872; professional territory covers the State of Michigan.

John H. Farish, St. Louis, Missouri

Born in St. Louis, Mo.; active member, St. Louis Real Estate Exchange; professional territory covers St. Louis City and County; Director, Title Insurance Corp.; Director, St. Louis Country Club; Director, Industrial Club; Director, Business League; Director, St. Louis Chamber of Commerce; Instructor of class in Ethics; A.B. degree, Georgetown College, D. C.; L.L.B. degree, Washington University, St. Louis; A.M. degree, St. Louis University.

Harry J. Stevens, Newark, N. J.

Born in Newark, N. J.; broker member, Newark Real Estate Board; professional territory covers the State of New Jersey; President, Newark Real Estate Board; Secretary, South Mountain Estates; Vice-President, Franklin Washington Trust Co.; Secretary, Century Holding Company; Vice-President, Woodmen Building & Loan Assn.; Secretary, Holland Building & Loan Assn.; Secretary, Trustworthy Building & Loan Assn.; Development Manager, Larchmont Estate; author-lecturer; real estate

appraising experience covers a period of twenty-three years.

James A. O'Connell, New Brunswick, New Jersey

Born in New Brunswick, N. J.; member, New Brunswick Real Estate Board; sole owner, James A. O'Connell Real Estate and Insurance Agency; professional territory covers New Brunswick and Middlesex County; director and appraiser for the Middlesex Title Guarantee and Trust Company; actively engaged in the real estate business since June, 1909.

Arthur J. Horton, Brooklyn, N. Y.

Active member and Director, Brooklyn Real Estate Board; Vice President, Bulkley & Horton Company; Director, Long Island Real Estate Board.

George S. Horton, Brooklyn, N. Y.

Active member and President, Brooklyn Real Estate Board; President, Bulkley & Horton Company; Director, Brooklyn Bond and Mortgage Company; Chairman of Executive Committee, Lafayette National Bank; President, Bulkley & Horton Holding Company; President, Lafayette Bank Shares Corp.; President, 71 Brooklyn Avenue Corp.

M. C. O'Brien, Brooklyn, N. Y.

Born in Lawrenceville, N. Y.; President, M. C. O'Brien, Inc.; professional territory covers the County of Kings, N. Y.; active member, Brooklyn Real Estate Board; trustee, Lincoln Savings Bank; member, Advisory Board, Manufacturers Trust Co.; trustee, Brooklyn Law School; graduate, St. Lawrence University, B. S. degree, 1909; valuation experience covers appraisals of business and office building properties, apartment houses, and other various types of property.

William F. MacDermott, Jamaica, N. Y.

Born in Brooklyn, N. Y.; President, Long Island Bond & Mortgage Guarantee Co.; professional territory covers Queens County, City of N. Y. and Nassau County, Long Island, N. Y.; active Executor of an estate with real estate holdings of approximately \$1,500,000 in land and buildings; active member, Long Island Real Estate Board; for the past twenty-five years has been associated with the Long Island Bond & Mortgage Guarantee Co.; for the last fif-

teen years has been actively engaged in the appraisal of real estate of all types for mortgage purposes; has had extensive experience in building houses for sale and investment.

Granville H. Rome, Jamaica, New York

Active member, Long Island Real Estate Board; Vice President, Bulkley & Horton Company; Vice President, Brevoort Savings Bank; Chairman of Appraisal Committee, Brevoort Savings Bank; Vice President and member Appraisal Committee, Bulkley & Horton Holding Company; Vice President and member Appraisal Committee, Sunshine Properties.

C. S. Noble, Winston Salem, N. C.

Born in Anniston, Alabama; active member, Winston Salem Real Estate Board; Vice-President, North Carolina Association of Real Estate Boards, 1933; Past President, Winston Salem Real Estate Board, 1921, 1922 and 1932; Vice-President and Secretary, The Pilot Company; Secretary, Buena Vista Annex, Inc.; Vice-President, Standard Improvement Company; Director, Standard Building & Loan Association; Member, Appraisal Committee, Standard Building & Loan Association since 1926; Member, Appraisal Committee, Win-

ston Salem Real Estate Board for 6 years; Chairman, Tax Revaluation Committee, Forsyth County, 1933; professional territory covers Winston Salem and Forsyth County, N. C.; B. S. degree, Architectural Engineering, Alabama Polytechnic Institute, 1914.

K. Lee Hyder, Milwaukee, Wisconsin

Born in Kansas City, Mo.; member, Milwaukee Real Estate Board; assistant vice-president in charge of the Engineering Division, The American Appraisal Company, Milwaukee; directly responsible for investigations, appraisals and reports upon land, leaseholds, all classes of investment properties, and natural resources, including appraisals for financing, condemnation, and various other purposes; registered architect in State of Michigan; member, Michigan Society of Architects; member, Society of Industrial Engineers; member, Architectural Society, University of Pennsylvania; three years' course in civil engineering, Colorado College, Colorado Springs, Colo.; one year's course, architecture, University of Pennsylvania, Philadelphia, Pa.; three years' course, architectural design, Society of Beaux Arts Architects; 21 years experience in architectural practice, building construction, estimating, and appraisal work.



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Peter Hanson, Glendale, California.
Philip W. Kniskern, New York City, N. Y.
Cuthbert E. Reeves, Buffalo, N. Y.
J. Alvin Register, Jacksonville, Florida.
Maurice F. Reidy, Worcester, Mass.

Term Expiring December 31, 1934

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A. C. Houghton, Washington, D. C.
Mark Levy, Chicago, Illinois.

Term Expiring December 31, 1933

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Samuel C. Kane, Philadelphia, Pa.
Norman L. Newhall, Minneapolis, Minn.
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**Roster of Members**

The officers of the Institute announce with sincere regret the death of George L. Atkins, M.A.I., Trenton, New Jersey. Admitted Jan. 27, 1933. Died May 31, 1933.

CALIFORNIA

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PETER HANSON.....520 Security Building
Long Beach
J. MORTIMER CLARK, Clark & Maspero.....
.....409 Security Building
J. C. HOFFMAN.....307 F. & M. Bank Bldg.
A. G. MASPERO, Clark & Maspero.....
.....409 Security Building
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STANLEY L. McMICHAE.....6785 Whitley Terrace
GEORGE L. SCHMUTZ.....8703 Santa Monica Blvd.
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IVAN A. THORSON.....617 S. Olive Street

North Hollywood

RALPH BRASHEAR.....10602 Magnolia Boulevard

Oakland

JAMES G. STAFFORD.....5820 Presley Way

Sacramento

MARK CHEESMAN819 J. Street

A. J. DELANO.....819 J. Street

W. S. GUILFORD.....Sutter Club

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THOMAS FRANCIS MASON.....303 Avalon Blvd.

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JOSEPH P. KENNEDY.....720 Main Street

New Haven

HENRY MUSCH, JR.....9 Center Street

DISTRICT OF COLUMBIA**Washington**

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JOSEPH A. HERBERT, Jr.....1013 15th Street, N. W.

A. C. HOUGHTON.....1516 H Street, N. W.

MORTON J. LUCHS.....1505 H. St., N. W.

CURTIS WALKERTower Bldg.

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Jacksonville

V. M. COVINGTON.....1316 Graham Building

LOUIS R. FENDIG.....2nd Floor, Buckman Building

MYRON L. HOWARD.....516 Professional Building

J. ALVIN REGISTER.....114 Graham Building

BAINBRIDGE RICHARDSON.....117 W. Forsyth St.

LAWRENCE K. TUCKER, JR.....319 W. Forsyth St.

Miami

HOLLIS BUSH711 Ingraham Bldg.

KENNETH S. KEYES, The Keyes Co., Inc.....First Trust Building

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D. EARL WILSON.....1017 Security Building

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GEORGE F. BRASS.....Box 1052

HAROLD V. CONDUCT.....Box 1052

G. JACKSON, Jr.....62 E. Pine Street

C. W. REX.....Box 293

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Sarasota

FRED L. PALMER.....482 Main Street

Tampa

CHARLES P. GLOVER.....201 E. Lafayette

Vero Beach

FRANK R. JEWETT.....P. O. Box Q

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JOHN P. HOOKER.....140 S. Dearborn Street

A. K. HORNOF.....1411 1st Natl. Bk. Bldg.

WALTER R. KUEHNLE.....2842 Eastwood Ave.

MARK LEVY.....7 S. Dearborn Street

ERNEST H. LYONS.....120 S. LaSalle St.

GEORGE ROBERT QUIN.....36 S. State St.

J. SOULE WARTERFIELD.....3 S. Dearborn Street

Galesburg

RALPH V. FIELD.....203 Bank of Galesburg Bldg.

Waukegan

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Indianapolis

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FRANK B. McKIBBIN.....129 E. Market St.

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ARTHUR S. KIRK.....900 Grand Avenue

Sioux City

WILLARD L. FROST.....Security Bank Building

KANSAS**Hutchinson**

J. C. McNAGHTEN.....

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W. E. FERGUSON.....100 E. Pleasant Street

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ALBERT C. HOFRICHTER.....1109 Lexington Bldg.

CHARLES H. STEFFEY.....336 N. Charles Street

Bethesda

H. WENDELL FITZGERALD.....P. O. Box 53

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MYER MARKELL.....Granite Block

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ISIDORO QUINTANA.....213 Main Street
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D. E. C. SOMERS.....700 Bergen Ave.

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JOHN FEDOR.....540 S. Wood Avenue

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MURRAY APFELBAUM.....786 Broad Street
JOHN J. BERRY.....930 Broad Street
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LOUIS HERMAN.....60 Park Place
JOHN A. LINNETT.....29 Elizabeth Street
E. J. MAIER.....40 Clinton Street
JOEL L. SCHLESINGER.....31 Clinton Street
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JAS. A. O'CONNELL.....392 George St.

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MORRIS GOLDFARB.....279 Madison Avenue

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SAMUEL S. WALSTRUM.....

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IRVING I. ROSENBAUM.....384 Broadway

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E. L. OSTENDORF.....1106 Chester Avenue
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London, Ontario

BERT WEIR.....156 1/2 Dundas Street

Toronto, Ontario

FRANK McLAUGHLIN.....34 King Street, West

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